S.HRG. 98-303

THE POLITICAL RISK INSURANCE ACT OF 1983

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 1568

TO AUTHORIZE THE SECRETARY OF COMMERCE TO PROVIDE INSURANCE AGAINST LOSSES CAUSED BY THE IMPOSITION OF EXPORT CONTROLS UNDER SECTION 5 OR 6 OF THE EXPORT ADMINISTRATION ACT OF 1979

JULY 27, 1983

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THE POLITICAL RISK INSURANCE ACT OF 1983

WEDNESDAY, JULY 27, 1983

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY,

Washington, D.C.

The subcommittee met at 2:30 p.m., in room SD-538, of the Dirksen Senate Office Building, Senator John Heinz (chairman of the subcommittee) presiding.

Present: Senators Heinz and Dodd.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. The subcommittee will come to order.

Today the subcommittee will explore the question of whether the U.S. Government ought to develop an insurance program to protect U.S. exporters against the actions of their own Government.

A bill proposing such a program has been introduced by my colleague, the Senator from Connecticut, Senator Dodd, who will be returning from the floor in just a few seconds.

While such a proposal may sound strange to many in this audience, many of our trade competitors already offer that insurance. The main difference between them and us, of course, is that the U.S. Government is well known for its propensity to impose export controls for political purposes. That tendency has led to a great deal of tension with our allies and a number of proposals to put limits on the President's power to use trade for international leverage.

The Senate will soon be considering S. 979, the Export Administration Act, reported by this committee which makes a number of significant proposals regarding the President's prerogatives under the Export Administration Act. This bill relates to that same issue but it approaches it after the controls have been imposed.

I look forward to the testimony of the witnesses who will be commenting on the bill. We are grateful for them participating and we are interested in particular in their views on political risk insurance.

I am particularly interested, as well, in their opinions regarding the feasibility of Senator Dodd's proposal, whether on balance that proposal will benefit or hurt the U.S. exporting community and whether this bill might not have a perverse effect by making export controls even more attractive to a President looking for political leverage.

I'm obligated to wait for Senator Dodd. I apologize to the witnesses for not being able to start the hearing on schedule and we will withhold just 1 minute.

Senator Dodd.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. Thank you, Mr. Chairman.

First of all, Mr. Chairman, I'd like to welcome our witnesses here today and thank them for taking time out of what I know is an extremely busy schedule for all of them to be here. In particular I'd like to welcome Mr. William Newman of Litton Industries from Hartford, Conn., who is here. We are also honored to have Mr. Stephen Merrett who has flown all the way from London to be here for the hearings today and certainly I want to thank you, Mr. Chairman, for convening this hearing on what I view as an important element on our export control policy.

When this committee marked up S. 979, the Export Administration Amendments of 1983, we undertook a major effort to reconcile the benefits of increased trade with the occasional need to restrict that trade to meet other important national goals. I think the changes in licensing, enforcement, foreign availability determinations, and interagency coordination that are included in S. 979 are all major improvements. The committee also included a very tough contract sanctity provision.

Yet, no matter what steps we take to limit the situations under which Presidents can impose foreign policy controls—under the Senate bill or any other bill for that matter—we cannot, and would not want to eliminate the President's authority to impose controls under certain circumstances. That fact is the basis for this legislation. It is designed to afford American exporters some additional financial protection against the losses that will inevitably occur when foreign controls are imposed in the future.

This idea is not a new one. Other major trading nations, such as West Germany and Japan, offer their companies political risk insurance, including export control insurance, through either public or quasi-public entities. Ironically, in the United States, which has a record of imposing export controls far more often than any other nation, political risk insurance is either inadequate or unavailable. It is my understanding that, whether it is offered by the private sector or the public sector, it is unavailable, unaffordable or too limited in scope to meet the needs of our exporters.

I anticipate that today's hearing will help us assess the accuracy of my belief and the dimensions of the problem. If the problems are as severe as I understand them to be, then this hearing should help us determine the best way to make sure that affordable political risk insurance is available to soften the blow to exporters from the imposition of export controls in the future. While such insurance would not solve all of our problems, including the loss of markets to foreign competitors, I believe it would be another major step toward encouraging our exporters.

Mr. Chairman, I look forward to the testimony of our witnesses. Just briefly, for the record, S. 1568 is written to cover exclusively

export control problems. No other "political risk" situation would be covered under this particular legislation.

The title of the bill, Political Risk Insurance, as you know, suggests a variety of forms, including insurance against war, nationalization, expropriation, and so forth. This bill, as I mentioned, only covers export controls. I think it's necessary because we do need to do everything in our power to encourage private sector exporters to become aggressive overseas if we're going to be competitive in the future. Certainly we are going to have Presidents, including this one and future ones, who will impose export controls for a variety of reasons. We hope it wouldn't happen very often, but when that does happen we ought to be able to at least alleviate some of the financial burdens of our exporters.

There are other provisions of the bill, Mr. Chairman. I'm not wedded to every dotted "i" and crossed "t" in this legislation.

I am very anxious for some constructive suggestions on how we might improve it in order to make it a workable component of a broader policy to improve our export position.

So again, I thank you for agreeing to having a hearing on this subject. One witness that we probably should have had with us today, but who is not here, is the FCIA. I would like to suggest that we ask the FCIA in writing what they think of this legislation and what we should do to improve political risk insurance generally. I think that might cover the situation better than having another hearing.

Senator HEINZ. Senator, I think that's a good suggestion. I don't see any problems with it as long as we can get the answers promptly so they're not academic.

Senator DODD. I totally agree. I thank you, Mr. Chairman. I look forward to hearing from our witnesses.

[Copy of bill S. 1568 follows:]

98TH CONGRESS
1ST SESSION

S. 1568

To authorize the Secretary of Commerce to provide insurance against losses caused by the imposition of export controls under section 5 or 6 of the Export Administration Act of 1979.

IN THE SENATE OF THE UNITED STATES

JUNE 29 (legislative day, JUNE 27), 1983

Mr. DODD introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To authorize the Secretary of Commerce to provide insurance against losses caused by the imposition of export controls under section 5 or 6 of the Export Administration Act of 1979.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. Section 4 of the Export Administration Act of 1979 is amended by adding at the end thereof the following:

"(g) INSURANCE AGAINST LOSS CAUSED BY EXPORT CONTROLS.—(1) The Secretary is authorized, upon such terms and conditions and in conjunction with such other Fed-

eral agencies as the Secretary may deem appropriate, to establish a program to provide exporters who elect to participate in the program insurance against losses, in whole or in part, caused by the imposition of export controls under section 5 or 6, including any losses incurred in the production and preparation for sale of goods or technology on which such controls are imposed.

"(2) The Secretary shall prescribe and collect premiums from participating exporters for insurance provided under this subsection, and shall establish premium rates at levels which assure that the program is run on an actuarially sound basis. Premiums collected under this subsection shall be deposited in a special fund which shall be available only for the purpose of this subsection. The Secretary may invest balances in the fund in excess of estimated current needs in obligations of the United States. Except to the extent of accrued premiums in the fund and any income on investments of the fund, the United States has no liability arising out of the imposition, expansion, or extension of export controls.

"(3) The Secretary is authorized to enter into agreements, including reinsurance agreements, with private insurers in order to carry out the insurance program under this subsection.

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"(4) All determinations by the Secretary with respect to claims for losses covered by insurance under this subsection shall be final.".

SEC. 2. This Act shall be referred to as the "Political Risk Insurance Act of 1983".

Senator HEINZ. Senator Dodd, I thank you. I would like to express my appreciation to you for bringing this subject to the attention of the committee. I would agree I think in general with your comments. It's an interesting idea. I'm not sure how well it will work. As I said in my opening statement, it may indeed make it a little easier and a little more attractive for people to use export controls for a variety of maybe not so good foreign policy purposes, and if those purposes are questionable, it will of course further undermine our reliability as a supplier. On the other hand, there's some utility in an idea like this where one agrees with the foreign policy purpose being involved.

Our first witness is the Honorable Larry Brady, no stranger to this committee, Assistant Secretary for Trade Administration. We are glad to have you. Please proceed.

STATEMENT OF LAWRENCE BRADY, ASSISTANT SECRETARY FOR TRADE ADMINISTRATION, DEPARTMENT OF COMMERCE, ACCOMPANIED BY PETER DALMUT, GENERAL COUNSEL, AND CECIL HUNT, ASSISTANT GENERAL COUNSEL FOR TRADE ADMINISTRATION, DEPARTMENT OF COMMERCE

Mr. BRADY. Thank you, Mr. Chairman.

Mr. Chairman, we appreciate the opportunity to testify today on S. 1568. I have with me today on my right Mr. Cecil Hunt, who is Assistant General Counsel for International Trade Administration at the Department of Commerce. Prior to his current position, Mr. Hunt was general counsel of OPIC and so he brings some experience with regard to these issues. On my left is Peter Dalmut, an attorney in the general counsel's office.

[Complete statement follows:]

STATEMENT OF LAWRENCE J. BRADY, ASSISTANT SECRETARY OF COMMERCE FOR TRADE ADMINISTRATION

We appreciate the opportunity to appear and testify on S. 1568, legislation which, if enacted, would authorize the Department of Commerce to provide insurance against losses caused by the imposition of national security or foreign policy export controls.

Under this proposal, Commerce would prescribe and collect premiums for a fund to compensate exporters for losses incurred as a result of the President's decision to interrupt contracts signed between U.S. companies and foreign firms or governments affected by such controls.

The U.S. Government today has two major programs which protect U.S. companies against political risks associated with doing business abroad:

The Overseas Private Investment Corporation (OPIC) is a U.S. Government-owned corporation which facilitates the contribution of American private investment to the economic development of friendly, less-developed countries. The corporation sells insurance against the political risks of inconvertibility of currency, expropriation and war. No compensation, however, is offered in the event of imposition of export controls by the U.S. Government.

The Export-Import Bank (ExImBank) is an independent U.S. Government agency originally established in 1934 to promote trade to the USSR by assisting U.S. exporters through programs of loans, credit guarantees, and credit insurance. Thanks in part to the ExImBank program, United States-Soviet trade began to flourish in the pre-World War II years. In the post-war years, the ExImBank program played a major role in boosting U.S. exports to the world, including exports to the Soviet bloc. In 1974, however, Congress passed the Jackson-Vanik Amendment, which makes most Eastern Bloc countries ineligible for any U.S. Government program of credit, credit guarantees or investment guarantees unless certain conditions relating to immigration are met a Presidential waiver can be provided.

ExImBank currently makes available a pre-shipment insurance program for most countries through its private sector affiliate—the Foreign Credit Insurance Association (FCIA). This coverage includes protection against the cancellation or failure to renew a validated U.S. export license or the imposition of restrictions on the export of products not previously subject to license or restriction.

However, ExImBank pre-shipment coverage currently is unavailable for the USSR and Eastern Bloc countries, except for Romania and Hungary. Coverage for sales to the USSR has been suspended since the passage of the Jackson-Vanik Amendment. Coverage for Eastern European countries depends on whether ExImBank generally is allowed to operate in those countries.

In short, the U.S. Government has had, and continues to have, programs designed to promote overseas sales and investment by U.S. firms. However, these programs may not be available in all the countries for which they are needed. At the same time, their size is limited by the United States desire to minimize government participation in credit markets. Departures from this principle, we believe, tend to narrow the scope for free enterprise by strengthening the role of government and eroding the long-term competitiveness of the U.S. economy. I can understand, therefore, why you feel this insurance facility might be useful.

Let me take this opportunity to emphasize our strong commitment to mitigate the effects on U.S. firms of U.S. foreign policy and national security controls. For example, in the case of the Libyan controls, great care was taken to restrict coverage to exclude exports already under contract if the imposition of controls would not excuse performance.

In November 1982, President Reagan lifted all the controls he had imposed against the USSR despite its continuing participation in the repression in Poland. He did so to relieve the burden of controls on U.S. companies and their foreign affiliates. By November, we had agreed with our Allies to replace the temporary sanctions with permanent policies on trade with the USSR designed to reduce generous credit subsidies, minimize dependence on Soviet natural gas, and tighten controls on export of advanced technology, including that used in the energy sector.

The foreign policy controls against the USSR represented strong action on our part. The President was not prepared to stand by idly while the basic human rights of the Polish nation were destroyed. It is extremely unfortunate that numerous contracts, including those for the pipeline, were interrupted for a period of nearly eleven months. But, let us not forget the contracts signed at Yalta, Helsinki and Gdansk—these, too, deserve to be respected.

We should also remember that policies which apply to trade between free nations to so called West-West and North-South trade—may not necessarily apply in all circumstances between free nations and the Communist world. Trade between the United States and the USSR has, for each side, a significant political component—not because we desire it so, but because the clash of values and strategic interests makes it inevitable.

By no means is the United States the only country to mix trade and politics. The Soviet Union itself has been known to use a pronounced "carrot-and-stick" approach to trade, not only with respect to its satellites, but also with nations in Western Europe and the Third World. To take another example, the European Community imposed stiff penalties against Argentina over the Falkland Islands dispute, and threatened to take action against Israel following the invasion of Lebanon. The use of economic instruments of diplomacy is a fact of life for all nations, much as we regret the impact in a highly interdependent world.

Given these constraints we have, nonetheless, sought to enhance our reputation as a reliable supplier of exports by lifting the grain embargo. Congress has provided that no contract may be interrupted by foreign policy controls for a period of 270 days following impositions of controls, except for a national emergency of a declared state of war. Similar protection, with a Presidential override, is contained for non-agricultural commodities in our proposal to extend the Export Administration Act (EAA) of 1979. I would also call your attention to Section 2 of the Administration's version of the EAA which states:

"It is the policy of the United States when imposing new foreign policy controls to minimize the impact on pre-existing contracts and on business activities in allied or other friendly countries to the extent consistent with the underlying purpose of the controls.

"It is the policy of the United States to develop licensing mechanisms to minimize the burdens placed on U.S. export trade, particularly U.S. export trade with member countries of COCOM, Australia, and New Zealand."

Thus, we have demonstrated willingness to modify controls in view of their effectiveness and their burden on the business community and to take these into account

when applying any future controls. This Administration is now placing far greater emphasis on coordination of East-West trade policy with the Allies, recognizing that unilateral controls, though sometimes necessary, quickly lost their effectiveness if the U.S. acts alone.

I would now like to turn my attention to the specific features of S. 1568.

Given the steps the Administration and Congress have taken to minimize the use of export controls and to protect contract sanctity, we question whether an expensive, government-run program is required given the availability of insurance coverage in the private sector.

We see no compelling reason why the government should enter into competition with private insurance carriers in this instance. Since the Government has no actuarial experience with such a program, rates would have to be set arbitrarily, with the risk that if they are too high the program will price itself right out of the marketplace. If they are too low, of course, companies may be inadequately compensated for losses.

In addition to the Administration's underlying view that the proposed program is not an appropriate Government activity, there are a number of technical questions that arise. For example, if new export controls are imposed, the Government would need to make determinations concerning the value of contracts signed with the target country, and whether the contracts were actually breached as a direct result of the controls. Estimating the losses incurred by a particular company in the production and preparation for sale of goods or technology also will not be easy.

In conclusion, while we share the objectives of S. 1568 to minimize the burden on the U.S. business community created by national security and foreign policy export controls, this Administration continues to believe that the Government's primary concern should be the reduction of loss to companies, not compensation. We think these concerns are adequately addressed in the Administration's willingness to provide a high degree of contract sanctity in foreign policy cases.

Senator HEINZ. Thank you very much, Secretary Brady.

You said that you oppose this because of the cost. That is correct, is it not?

Mr. BRADY. Yes, sir. It's one of the reasons we oppose it.

Senator HEINZ. If this were made to be actuarially sound, would you still oppose it?

Mr. BRADY. Mr. Chairman, it's how we define actuarially sound that might be something worth looking at. I think we are torn between the contradictions we see in the program; namely, having premiums so high that no one will make themselves available to the program, or the other side, having them so low or low to the extent that one liability would wipe out the program.

I have to tell you that we also look down the road and although there's no Government guarantees at the moment in the measure, the experience of the Federal Government with these type of programs is that they begin very small and, as a snowball going down the hill, tend to grow; and the administration would in the strongest terms possible oppose any Government guarantees.

There is, of course, the burden of administering the program, so it's not without some cost.

Senator HEINZ. I think it's fair to say that one of the reasons that Senator Dodd introduced this legislation is that he feels there may have been an identifiable private market failure in the area of political risk insurance such that there is a call for government intervention.

Do you agree with that?

Mr. BRADY. Mr. Chairman, I think we have—well, I think the witnesses this afternoon can address that certainly as well, if not better, than I can because they are actually the practitioners and whatever I give you will be second or third hand.

STRENGTHEN EXISTING INSURANCE PROGRAMS

It's my understanding that there is political risk insurance available. There is already a program, as I indicated, the FCIA program exists. It is the Congress that has put constraints on that program; namely, the Jackson-Vanik amendment, and those constraints are not minor ones and they address the very countries which I assume this proposal would address.

Senator HEINZ. Would this program, if it were actuarially sound, whatever we mean by that—and I'm not being facetious when I say that—the definition of what is or isn't actuarially sound around here is a good one. We wrestled with the question whether social security was in some sense actuarially sound about 1½ years ago and people still disagree. The President agreed enough to sign the legislation.

But if we did have an actuarially sound program, would such a program tend to keep prospective private insurers out of the market?

Mr. BRADY. Again, I think I would like to see that question addressed to the other witnesses this afternoon.

Senator HEINZ. All right.

Mr. BRADY. Because, to a certain extent, we are going through this with you in terms of giving you the opinion of the community involved in the process.

Senator HEINZ. It's a new idea to you, too. Let me ask you this. We have had some efforts over the years that don't quite match what Senator Dodd's legislation seeks to achieve, but it parallels it.

For example, the Eximbank through its arrangements with FCIA has in the past provided insurance against domestic export controls. They do, however, charge an initial premium over and above their political risk insurance and they also do not provide insurance to Communist bloc countries where the insurance is most needed.

Would it, nonetheless, be more efficient if we did reach agreement on the concept—and we have not as yet done that—to strengthen existing programs such as OPIC or FCIA than to set up still another program in Commerce? Do you have any opinion on that?

Mr. BRADY. Mr. Chairman, I don't think there's any question but that we, certainly in Commerce—and now I speak as a Commerce official——

Senator HEINZ. What were you speaking as before?

Mr. BRADY. I was speaking as an administration official. We would tend to think that the program might be lodged in one of the existing agencies. So my answer would be very definitely yes.

Senator HEINZ. Thank you.

Senator Dodd.

Senator DODD. Thank you, Mr. Chairman.

Mr. Brady let's assume you're in the private sector. I'm not making a prediction at all or wishing that fate, but just for a second let's assume you're an exporter. And given the track record on export controls, given the absence of insurance, as an exporter, how likely do you think you would be to sign a contract, say, with

Soviet bloc countries or other nations outside the Soviet bloc who are affected by prohibitions insurance coverage?

Mr. BRADY. Well, Senator, one, it's my understanding that there are private programs in existence that do provide insurance of the kind that you're suggesting be provided in your bill.

I think we're at the point, however, with regard to the business community——

Senator DODD. Let me ask you another question. Has the Commerce Department done a survey of exporters and other people involved in this business to draw that conclusion? Do you know that to be the case factually, with respect to prices and availability? Is that statement based on hard data, or is it just an assumption?

Mr. BRADY. Senator, we are aware that some programs exist. I would be happy to share whatever sound data that we have with you. I don't know how extensive it is as a point of fact, but we do know that programs exist and I think your witnesses this afternoon will indicate that some of those insurance programs exist.

Senator DODD. Then you've not concluded, in fact, that there are existing programs of one kind or another; availability and affordability have not been adequately addressed by the Commerce Department to substantiate that statement.

Mr. BRADY. We are aware, however, Senator, that in the private sector the insurance premiums are quite high for this kind of insurance and there would be a desire on the part of certainly—if the Government was to administer a redundant program or an overlapping program or a like program—there would have to be some reason to entice the business community to come to the Government organized program rather than to a private program.

As you know, the philosophy of this administration is not to duplicate what is available in the private sector and that goes from domestic programs to a program like this.

EXPORTERS INSURANCE MUST INCLUDE COMMUNIST COUNTRIES

Senator DODD. Well, I'm not suggesting that's what we ought to be doing. In fact, that's why I asked the question about the data base to substantiate the claim. This isn't an idea that just sprang up in an office here. There are a number of people representing a broad spectrum of exporters that have expressed deep concern about the absence of this kind of problem. They're not looking to the Government for solutions to every problem they have.

What they see here, and I agree with them, is a gap that needs to be filled, and it's in the interest of national security, economic development, and stability to do so.

Wouldn't you agree, if there was an absence of opportunity in the private sector, a major problem, then it would be appropriate to develop that missing link in the public sector so that we might encourage further expanded activity in export markets and industries?

Mr. BRADY. I think I'd like to make two points, Senator. One, I'm not sure the bill addresses the very problem which is caused, for instance, as a result of the FCIA prohibition, the Jackson-Vanik prohibition. It seems to me that we need insurance with regard to

the very countries for which the premiums are going to be so high, for which as I indicated in my statement the rules commonly applied to West-West and North-South don't apply; namely, the Communist bloc.

The second point I'd like to make is that this insurance does not really address the reliability of supplier problems that the industry tells us we have at this point because it doesn't allow a manufacturer or a supplier to deliver his goods. All it does is compensate him in whole or in part should export controls be applied. So that we don't deal with the more fundamental problem which is the reliability of supplier problem which, again, the business community tells us they have. I think we should break that problem down.

I totally agree that the United States as an exporting nation must double and triple its efforts. All we have to do is look at the statistics and the conclusions are drawn for us. But I think we've got to isolate the problems. The Communist world is one. The rest, the Third World, is another; and then you have the developed countries. I think basically there are three areas and it's difficult to apply the logic of one to another.

And I think that's the problem we are having when we talk about insurance. The business community would like it applied to Communist countries where we have had fairly extensive use of foreign policy controls and it in essence begs the question.

Senator DODD. Well, let me ask you to provide for the committee in the most expeditious manner possible, information on types of coverage that are available and the number of exporters who have suffered as a result of export controls and who therefore might want some coverage. I think that would help us a bit.

Second, I wonder if you might take a look—and I presume you have—at the bill. As you know, the bill as presently drawn does not tap the public trough, which is a problem that the exporters have to some degree with it, but rather, the fund would be based on premiums collected from participating exporters.

So your statement about the fiscal impact of it is really not as pronounced, is it, as the bill is presently drawn?

Mr. BRADY. No, you're right, sir. One of our concerns goes beyond the bill as presently drawn and it looks at the precedence in the last 20 years of what happened certainly on the domestic side of our programs, and I think there would be very, very strong pressure in the future to bring about Government backing for that, and that's when you get to a real fiscal problem.

But we will be very happy to supply you as promptly as we can the information you asked for.

[Information supplied can be found on p. 53.]

Senator DODD. Also, if my memory serves me well, the administration opposed the contract sanctity provisions that this committee adopted; is that correct?

Mr. BRADY. Senator, we continue to oppose them very strongly.

Senator DODD. What do you think the reaction is among exporters for that kind of position with regard to future export controls?

EXPORTERS AND PRESIDENT MUST COMPROMISE

Mr. BRADY. Senator, we have tried in the very extensive discussions we had with the business community prior to putting together what we call the Reagan proposal to balance the foreign policy and national security interests of the United States on the one hand with the very legitimate business interests on the other, predictability, consistency, the need to have reputation as a reliable supplier.

The recommendations we made to the Congress provided for a provision basically similar to what the Congress wrote with regard to agricultural commodities back in 1981, with a national interest override. That was coupled with some language in the policy section of the amendments that we submitted which left no doubt where the administration stood.

The business community, I recognize, is not satisfied with that. They would like to have an ironclad guarantee of the kind that this committee is apparently reporting out to the floor. We have difficulty with that because it ties the President's hands. It ties the President's hands severely and we object to it as a matter of fact. We thought our proposal was a balanced one, taking into account those business concerns but also giving the President flexibility in the foreign policy and national security area.

Senator DODD. Well, as my chairman knows, I am somewhat more inclined to your position on that particular point. I'm very worried about that problem in terms of the exercise of foreign policy, but if I were an exporter sitting in this audience I'd be uneasy.

What I'm trying to do is to address a legitimate worry at the very hour that we want to encourage the private sector to become more active in export markets. Political risk insurance for the imposition of export controls is one way to allay some of the uneasiness that exists.

Now I'm a little perplexed as to why the Commerce Department or the administration, worried as it is over this committee's position on contract sanctity, would not want to offer some form of insurance program which would build confidence within that sector.

Mr. BRADY. Again, Senator, I can only restate what I said a few moments ago, that there are programs in the private sector, that the prohibitions that apply on the use of Government programs, namely, the Jackson-Vanik amendment, reach into the very area where apparently this legislation is designed to deal with, and it's an area that, regardless of the prohibitions we have, is going to be contentious because it is politicized.

Senator DODD. That fact has not been determined by Jackson-Vanik. Has your legal staff concluded definitively that Jackson-Vanik would have that impact?

Mr. BRADY. I will defer to Mr. Hunt.

Mr. HUNT. Senator Dodd, both OPIC with respect to its investment insurance programs and the Export-Import Bank with respect to its programs have determined that their existing programs are subject to the provisions of Jackson-Vanik. In the case of the Export-Import Bank, they have their own limitations in their own legislation.

Now with respect to S. 1568, it would be a matter for the Congress to make its intent clear or it could say in this bill the program proposed here could be completely dissociated from credit insurance or export-control credit so that literally it might not come within the present wording of Jackson-Vanik, but it would be important for the Congress to make that clear, that that is its intention, to have placed outside of Jackson-Vanik a particular type of insurance that was separated from export controls.

Senator DODD. Simple language like "not withstanding any other provisions of law"?

Mr. HUNT. That is the time-honored language.

Senator DODD. Thank you very much. My time has expired.

Senator HEINZ. Thank you, Senator Dodd.

Mr. Brady, thank you very much. We appreciate your testimony. If we have any questions for you, you can be assured that we will send them along to you.

Mr. BRADY. Thank you, Mr. Chairman.

Senator HEINZ. Our next witnesses is a panel consisting of Mr. Seccombe, Mr. William Newman, and Mr. Thomas Schinkel.

Gentlemen, please give us your full particulars as I call on you in turn. I would just note that Mr. Newman, who is representing Litton Industries, has a significant presence in Pennsylvania and it's not too late for any of the rest of you gentlemen to go on the record here today that you wish to employ more people in Pennsylvania as well. Any announcements in that regard would be especially welcome in the areas of high unemployment.

The Chair will express some disappointment that there was no outpouring of the immediate establishment of new job opportunities in the State at this point, but he remains optimistic.

Let me ask Mr. Seccombe to be our leadoff witness.

STATEMENT OF ROBERT J. SECCOMBE, VICE PRESIDENT, AUTOMATED PRODUCT SYSTEMS DIVISION, INGERSOLL-RAND CORP., WOODCLIFF LAKE, N.J., ACCOMPANIED BY BARRY J. ISRAEL, ESQ.

Mr. SECCOMBE. I was just going to say that Ingersoll-Rand is also a major employer in the State of Pennsylvania, as you're probably aware of.

[Summary and complete statement follow:]

SUMMARY OF STATEMENT OF ROBERT J. SECCOMBE, VICE-PRESIDENT, AUTOMATED PRODUCTION SYSTEMS DIVISION, THE INGERSOLL-RAND CO.

Mr. Chairman, members of the Subcommittee, I am Robert J. Seccombe, Vice-President of the Automated Production Systems Division (APS) of the Ingersoll-Rand Company. Accompanying me is Mr. Barry J. Israel, of the Law Firm of Stovall, Spradlin & Israel, who has been assisting us on this matter. The APS Division of Ingersoll-Rand is a world leader in the production of automated systems for the assembly and testing of automobile and truck drive train components. We appreciate your invitation to appear before the subcommittee to discuss what we believe is a critical need for Government sponsored political risk insurance protecting exporters against the imposition of export controls by the U.S. Government. We have prepared a written statement which I would like to submit for your review. I would also like to take a few minutes to summarize the problem presented therein.

We are appearing before you because of our inability to obtain political risk insurance against embargo actions by the U.S. Government. The unavailability of this insurance has substantially damaged my division which for the last two years has been effectively precluded from exporting many of its products to sensitive trade

areas. To this end, we would like to express our deep appreciation to Senator Dodd who has recognized the dilemma that we find ourselves in and has proposed a remedy. We hope that the program of Government sponsored political risk insurance he has proposed in Senate bill S. 1568 will help focus the Congress on the detrimental effect selective use of export controls can have on U.S. business. By doing so we are hopeful that a legislative solution will be immediately forthcoming.

As we understand it our Government's policy remains one of permitting, if not actually encouraging, appropriate trade with sensitive trade areas such as the Soviet Union and Eastern bloc countries. Ingersoll-Rand and other companies like ourselves are precluded from these active markets even for products which are not covered by any export restrictions, because uncertainty over United States export policy has made it impossible for companies like ourselves to obtain political risk insurance. The private insurance industry which in the past offered political risk insurance covering action by the United States Government to manufacturers of specially engineered products like ours now refuses to offer it. Presumably this is the result of unpredictable United States export policy.

In the past eighteen months Ingersoll-Rand has been offered substantial contracts by the Soviet Union and East Germany for assembly and test systems which are not subject to any U.S. restrictions. However, Ingersoll-Rand has been unable to secure insurance coverage even for products approved for shipment under a general destination license. In an attempt to alleviate the insurance company's concerns, Ingersoll-Rand sought a degree of Government assurance that present policy would not change and that we would be permitted to export the products as scheduled if we were awarded a contract. The response demonstrates the very substantial dilemma we face. In November of 1981, we wrote to Secretary Baldrige requesting that the Department of Commerce advise Ingersoll-Rand that the equipment involved could be shipped under a general destination license and that such license would not be revoked prior to completion of shipment. Secretary Baldrige responded that the equipment in question could indeed be shipped under a general destination license. But he also stated that "unfortunately, I am unable to provide you with specific assurances over any particular time period because this license classification determination can only reflect our current policy in a very sensitive trade area."

Obviously the Secretary retained the right to impose future restrictions. In effect, Ingersoll-Rand and the insurance companies are forced by Government policy to play Russian roulette if they intend to remain in the market. Rather than take these risks, the private insurance companies have refused to offer political risk insurance for export of specially engineered equipment such as that manufactured by APS to the eastern bloc. The immediate result is that Ingersoll-Rand either self insures or loses contracts to its European competitors. Ingersoll-Rand has had to choose the latter and most certainly will continue to lose future projects if a solution to the problem is not immediately forthcoming.

As Senator Dodd noted when offering S. 1568, the inability to obtain political risk insurance is not a problem that hinders our European competitors whose governments have established programs of political risk insurance which protects their exporters against government imposed trade restrictions. These governments have recognized the problems private industry is faced with when export restrictions are used as a tool of foreign policy.

I might mention that the availability of government sponsored political risk insurance in France, Italy, Germany, England, Canada and Japan creates a dilemma for companies like ours which have plants or own subsidiaries in each of these countries. Ingersoll-Rand, for instance, could manufacture nonrestricted products for export to the Soviet Union in its plants in either Canada, Europe or Japan and receive government sponsored political risk insurance protection. But if we do this we are not providing jobs at our domestic plants.

The current popular remedy in Congress and much of the bussiness world for the problems business is experiencing as a result of selective export controls is to amend the Export Administration Act to provide for the sanctity of existing contracts when foreign policy controls are imposed. But without political risk insurance we feel this is an illusory remedy. We are very concerned that those supporting this proposal are not considering realistically the weaknesses in it.

No sanctity of contract provision currently under consideration can be expected to prohibit absolutely or even substantially Presidential action to impose export controls on existing contracts. There are several reasons which must be considered. The most obvious is that as the administration made clear in Under Secretary of Commerce Lionel Olmer's statements of April 5, 1983 before the House Subcommittee on International Economic Policy and Trade, "The Administration intends to fight very hard to preserve flexibility to impose foreign policy controls even on existing con-

tracts when the President determines that overriding national interests require that such exports be prohibited."

If the President retains this flexibility, a sanctity of contract provision will only be one more guideline for the President to consider prior to imposing restrictions. Moreover, there is little doubt that statutory requirements for Presidential determinations do little to impede Presidential action in the area of foreign affairs. They tend to represent only formal technicalities. Well-established legal precedent demonstrates that when the President is acting under the color of statutory authority, this fact combined with the inherent powers of the President, make it unlikely if not impossible to convince a court to reverse him.

Perhaps the best evidence of the extraordinary discretion given the President is the utter absence of case law precedent defining the specific provisions of sections 5 and 6 of the Export Administration Act. There is no precedent even though it is widely recognized that both Presidents Carter and Reagan, when employing export controls over the last five years, ignored or gave only pro forma consideration to many of the restrictions currently in the act.

One reason for this absence of precedent is that most affected companies are simply reluctant to mount a public challenge to action by the President, particularly when actions are taken by the President in the name of overriding national interests and for which the President appeals for national support.

Even if the President's flexibility to restrict existing contracts is limited, the sanctity of contract proposals fail to address presidential authority under section 5 of the Export Administration Act—national security controls—or his authority under the International Emergency Economic Powers Act ("IEEPA"). If the President's hands are tied under section 6 foreign policy controls, there is absolutely no reason to believe he will not escalate his reaction and utilize either IEEPA or his national security controls authority under section 5.

There is one other issue we believe is being ignored in the debate over the issue of export controls. We believe corporate management should not underestimate the potential jeopardy it places itself in if it decides to self insure on a substantial project in the Soviet Union or Eastern Europe. The administration is very open about the possibility of the further imposition of controls.

If a corporate officer in the face of this policy participates in a project in a high risk area without political risk insurance, and project is embargoed, the possibility exists that corporate management could be made subject to a shareholders derivative suit or substantial criticism. Given present Government policy, self-insurance against political risk is a high risk business.

Because we do not believe sanctity of contract alone will provide a sufficient remedy, we encourage you to give immediate consideration to Senator Dodd's insurance proposal. This proposal recognizes the serious dilemma companies like ours face. Our written testimony offers a few suggestions on how we would revise Senator Dodd's proposal. We encourage you to take these into consideration as you proceed.

CONCLUSION

Too often the blame for the United States' severe balance-of-payments deficit is placed on American industry which is said not to have kept pace with the technological improvements of foreign competitors. We tend to ignore the detrimental effect the Government's use of selective controls plays in our ability to compete.

A program of political risk insurance along the lines proposed by Senator Dodd minimizes the unintended impact of these controls. We ask only that the government recognize the effect of its policies and establish an insurance program so that U.S. industry can again compete fairly in the international market and keep Americans working.

Thank You.

STATEMENT OF ROBERT J. SECCOMBE, VICE PRESIDENT, AUTOMATED PRODUCTION SYSTEMS DIVISION, THE INGERSOLL-RAND CO.

Mr. Chairman, Members of the Subcommittee, I am Robert J. Seccombe, Vice-President of the Automated Production Systems Division (APS) of the Ingersoll-Rand Company. Appearing with me is Mr. Barry J. Israel of the law firm Stovall, Spradlin & Israel who has been assisting us on this matter. The APS Division of Ingersoll-Rand is a world leader in the production of automated systems for the assembly and testing of automobile and truck drive train components. Our equipment is installed in all of the major automobile and truck assembly plants in the United

States and many others throughout the world. We greatly appreciate your invitation to testify before the Subcommittee to discuss what we believe is a critical need for a government sponsored program of political risk insurance.

We are appearing before you because of our inability to obtain political risk insurance against embargo actions by the U.S. which is, we believe, largely the result of the selective use by the Government of export controls. This unavailability of insurance has substantially damaged my company and will continue to do so if not remedied. We also wish to explain why we think the current effort in Congress to provide for sanctity of contracts when foreign policy controls are imposed is an incomplete remedy if not accompanied by government sponsored political risk insurance.

When using export controls as a tool of foreign policy, the United States has rarely employed these controls on an across-the-board basis resulting in a total embargo against a country. Rather the practice has been to select certain key products or technology for restrictions. Recent restrictions on trade with the Soviet Union are a good example.

While Administration policy does not prohibit all trade with the Soviet Union, the selective use of export controls has inadvertently made exports of unique or long-lead time products nearly impossible. This includes products that have not been restricted and often are shippable under a General Destination license. A principal reason for this is that the private insurance companies, apparently unable to assess the risk or unwilling to underwrite the risk of further controls, have stopped issuing political risk insurance protecting many American manufacturers and exporters of "long-lead time" or "specially engineered" equipment against future selective embargo actions by the United States Government.

Moreover, this uncertainty over United States' intentions with regard to trade with the Soviet Union has carried over into trade with certain other Eastern Bloc countries like the German Democratic Republic ("GDR"), even though the specific controls creating the uncertainty have not been directed at them. In effect American trade is suffering as a result of political and geographical association. The insurance companies seem to have decided that a substantial risk exists that selective controls may also be imposed on trade to these related countries and refuse to offer insurance.

While this problem is not unique to Ingersoll-Rand, our recent experience serves as a graphic illustration of the unintended impact of the present export restrictions. I believe a brief history of Ingersoll-Rand's recent difficulties in the export market will put this problem into perspective. In 1975, Ingersoll-Rand with United States Government encouragement and approval, exported an automated engine assembly line to the Soviet Union for installation at the Kama River Truck Plant. Ingersoll-Rand obtained this contract in competition with Italian, French and German manufacturers.

In the fall of 1978 Ingersoll-Rand was asked to manufacture a duplicate engine assembly line for Kama River. At that time, the product could have been shipped under a General Destination license with specific approval of the United States Department of Commerce. The technology involved in the requested assembly line was outdated by American standards and readily available from a variety of European producers. Completely satisfied with Ingersoll-Rand's earlier work, the Soviets did not approach European competitors for bids and, instead, let a single source ten million dollar contract to Ingersoll-Rand. As a part of the negotiations the Soviets did request assurance that an export license would be granted and we received this assurance.

During production, over the next year, Ingersoll-Rand repeatedly contacted the Departments of Commerce and Defense concerning the proposed export. Written assurances were received that a General Destination license was available, and no objections were ever raised that the United States Government had any reservations about permitting the shipment for national security or foreign policy reasons. Yet in a last minute reversal of policy, this duplicate system was embargoed in May of 1980 for foreign policy reasons only four days prior to shipment as the result of the alleged use of Kama-built trucks in the Soviet invasion of Afghanistan. The assembly line in question, too big to be cut up as scrap and without a potential market because it was designed specifically for Kama River, is now sitting in a warehouse. Fortunately, Ingersoll-Rand did possess political risk insurance on that project and has since received a settlement from the insuror for 90 percent of actual costs incurred.

Subsequent to the imposition of the restrictions, Ingersoll-Rand sought reconsideration by Department of Commerce officials and others, raising the probability that the Soviet Union could build the assembly line itself or would merely solicit bids from European competitors such as Comau, a division of Fiat. The restrictions were

retained, however. The contract with the Soviets was eventually cancelled in December, 1981.

In April of 1982, Ingersoll-Rand received an inquiry from the Comau Division of Fiat of Italy requesting that Ingersoll-Rand serve as a subcontractor on an engine assembly line project that, upon investigation, turned out to be the Kama River project. As predicted, the Soviet Union had turned to a European competitor. As a result not only were United States labor hours transferred to Italy, but it established a new substantial competitor for this type product that until this time had not existed.

In late 1981, the Ingersoll-Rand Company received a request from the GDR to bid on an assembly system for a commercial vehicle assembly plant constituting a potential 20 million dollar contract. About that same time, the Soviet Union requested bids on assembly equipment valued at 40 million dollars for the Togliattigrad automobile assembly plant. Although the assembly lines for both these projects can to this day be exported without specific United States Government approval pursuant to a General Destination license, Ingersoll-Rand sought Commerce Department assurance that participation in these projects would be permitted. This assurance was sought, in part, to attempt to satisfy the insurance industries' concerns. The response demonstrates the very substantial dilemma American business faces as a result of the imposition of selective export controls.

In November of 1981, Ingersoll-Rand wrote to Secretary Baldrige requesting that the Department of Commerce advise whether "the equipment being quoted for GDR and Togliattigrad may be shipped under a General Destination license and that such license will not be revoked prior to completion of shipment." Secretary Baldrige responded that the equipment in question could indeed be shipped under a General Destination license. But he also stated that "unfortunately, I am unable to provide you with specific assurances over any particular time period because this license classification determination can only reflect our current policy in a very sensitive trade area."

Obviously the Secretary retained the right to impose future restrictions. In effect, Ingersoll-Rand and the insurance companies are forced by government policy to play Russian roulette if they remain in the market. Rather than take these risks, the private insurance companies have refused to offer political risk insurance for exports to either of these projects. Without this insurance, manufacturers such as Ingersoll-Rand are simply unable to accept the potential risk involved in a multimillion dollar order and they, too, have virtually withdrawn from the market.

The immediate result of these lost contracts was further lay-offs of American workers at Ingersoll-Rand plants as well as subcontractors in the important machine tool industry which supports Ingersoll-Rand on projects like these. These two projects combined involved 380 man-years of labor. I feel certain that Ingersoll-Rand would receive contracts involving, at least, 183 man-years of work. Moreover, Ingersoll/Rand would have had to subcontract with other suppliers for about five million dollars worth of component parts. If Ingersoll-Rand had been able to participate in the contracts, it would have begun production of the equipment around March, 1982. Instead since February of 1982, Ingersoll-Rand has had to lay-off 135 of its own employees and terminate 255 outside contractors working in its plant.

Due to the depressed United States economy, major manufacturers like Ingersoll-Rand are forced to constrict operations. The ripple effect of these actions has serious implications for other supporting industries and ultimately, we believe, for the country as a whole. I need not detail the significance of a healthy machine tool industry to the defense and security of this country. Yet at a time when our Government is attempting to insure our continued strength abroad, the very foundation of this strength, a viable industrial base at home, is being eroded because of the inability of companies like Ingersoll-Rand to compete fairly in the international market.

OTHER GOVERNMENTS PROVIDE POLITICAL RISK INSURANCE

This inability to obtain political risk insurance is not a problem that hinders our competitors in allied countries where the governments have established programs of political risk insurance protecting exporters against trade restrictions. Foreign governments have stepped in to fill the void, acknowledging that, if they are going to utilize export restrictions for foreign policy purposes, they must take steps to counteract the negative effects of this policy.

Indeed the availability of government-sponsored political risk insurance in these countries creates something of an anomaly when American companies have plants or own subsidiaries in them. Ingersoll-Rand, for instance, could have manufactured the equipment for the Togliattigrad and GDR projects in its own plants in either

Canada or Europe and could have received government-sponsored political risk insurance. But this would not provide jobs at its domestic plants and would only add to already high unemployment in the United States.

If the United States Government is to use export restrictions as a tool of foreign policy, it too should recognize the existence of these unintended consequences and make provision to minimize them. Because export controls are used as an instrument of foreign policy, the loss of future business is a risk that American exporters must deal with. But it is inherently unfair for Government not to recognize that the uncertainty its policies engender seriously affects the ability of business to participate in otherwise permissible trade.

Very often export contracts involve extended production periods prior to shipment. Normal commercial practice calls for payment upon delivery. When controls are imposed during production or prior to delivery, a manufacturer may find itself in the position of holding partially or totally completed products for which no compensation has been received and for which there may be no other market. Political risk insurance has in the past been available to cover this period. It has not been available to APS since early 1981 and our frequent inquiries demonstrate there is little prospect for its return. Indeed within the last 90 days we have sought insurance for projects in the Soviet Union and East Germany but found no company willing to provide the insurance. Ironically, we were offered insurance against the possibility of cancellation by the Soviets. If this situation continues, Ingersoll-Rand and other American businesses will suffer and our international competitors will obviously benefit.

WITHOUT GOVERNMENT SPONSORED POLITICAL RISK INSURANCE SANCTITY OF CONTRACT PROTECTION WILL ALMOST CERTAINLY BE AN ILLUSORY REMEDY

The current popular remedy in Congress and much of the business world for the problems that are arising as a result of selective export controls is to amend the Export Administration Act to provide for the sanctity of existing contracts when foreign policy controls are imposed. Suggested amendments range from an absolute protection for existing contracts (S. 979, H.R. 3231) to the recent administration proposal which would grandfather those contracts providing for delivery within 270 days from the imposition of controls unless the President determines that the overriding national interest requires that such exports be prohibited. Compromise proposals are also being suggested which would require the President to meet certain criteria prior to imposing foreign policy controls. The purpose of these proposals, of course, is to provide as much protection as possible to American businesses so that they can again compete in the foreign market place. Ingersoll-Rand fully supports any such effort.

Yet, no sanctity of contract provision currently under consideration can be expected to prohibit absolutely or even substantially Presidential action to impose export controls on existing contracts; nor could they. There are several reasons which must be considered. The most obvious is that as the Administration made clear in Under Secretary of Commerce, Lionel Olmer's statements of April 5, 1983 before the House Subcommittee on International Economic Policy and Trade, it intends to fight very hard to preserve flexibility to impose foreign policy controls when the President determines that overriding national interests require that such exports be prohibited.

According to Under Secretary Olmer "while much criticism has been leveled against the effectiveness of Foreign Policy controls, they remain an instrument the President can use to exercise U.S. influence by a means short of military action." He went on to state that "at times, the foreign policy interests of this country demand certain actions, even though there may be significant corresponding costs. The President must have the flexibility and the authority to respond rapidly to unacceptable international behavior." Translated, this means that the President intends to retain as much authority as possible to place restrictions on exports if the national interest so demands.

If the President is given this flexibility, a sanctity of contracts provision will only be one more guideline for the President to consider prior to imposing restrictions. Well-established legal precedent demonstrates that when the President is acting under the color of statutory authority, this fact combined with the inherent powers of the President, makes it unlikely if not impossible to convince a court to reverse him.

Perhaps the best evidence of the extraordinary discretion given the President is the utter absence of case law precedent defining the specific provisions of Sections 5 and 6 of the Export Administration Act. There is no precedent even though it is widely recognized that both Presidents Carter and Reagan, when employing export

controls over the last five years, ignored or gave only pro forma consideration to many of the restrictions currently in the Act.

One reason for this absence of legal precedent is that most affected companies are simply reluctant to mount a viable public challenge to action by the President in all but the most extraordinary cases. This is particularly true when the situations involve, as they frequently do, actions taken by the President in the name of overriding national interests and for which the President appeals for national support. Take, for instance, President Reagan's extraterritorial application of export controls involving the construction of the oil and gas pipeline in the Soviet Union. Many legal authorities argued that this exercise of Presidential authority was of questionable legal validity. Yet, Dresser was spectacularly unsuccessful when it instituted legal challenges in the U.S. District Court and at the Department of Commerce.

Even if the President were not to achieve the goal stated by Under Secretary Olmer of preserving flexibility to restrict existing contracts, the sanctity of contract provisions do not address Presidential authority under Section 5 of the Export Administration Act—national security controls—or his authority under the International Emergency Economic Powers Act ("IEEPA"). If the President's hands are tied on foreign policy controls, there is absolutely no reason to believe he will not escalate his reaction and utilize IEEPA or his national security controls authority, since there obviously exists for Presidents a compelling attraction toward export controls.

While these restrictions may indicate Congressional policy to restrict the President and to channel the decision-making process, it is unlikely that existing contracts can be protected absolutely against the imposition of some kind of controls. This is not to say that any such limitation or channeling should not be pursued. Rather we suggest that sanctity of contract is an incomplete remedy and must be accompanied by a program of Government-sponsored political risk insurance.

There is one other issue we believe is being ignored in the debate over the issue of export controls. We believe corporate management should not underestimate the potential jeopardy it places itself in if it decides to self insure on a substantial project in the Soviet Union or Eastern Europe.

Corporate management must consider these facts. Export controls have been imposed at least nine times in the last five years. Current policy continues to involve chastizing the Soviet's whenever they appear to be taking aggressive action. The Administration is very open about the possibility of the further imposition of controls.

If a corporate officer in the face of this policy were to agree to participate in a substantial project in the Soviet Union or other high risk area without the protection offered by political risk insurance, and if that project were embargoed after substantial expenditures had been made, the possibility exists that corporate management could be made subject to a shareholders derivative suit or, at least, be the subject of substantial criticism. Given present Government policy, self-insurance is a high risk business.

Obviously Government-sponsored political risk insurance does not provide a complete remedy. It neither makes U.S. companies more reliable suppliers nor hinders absolutely the President's authority to act; nor would it allow recovery of lost profits. But in combination with a sanctity of contract provision, it provides management with sufficent assurances that they can risk bidding on projects and keep their factories operating. If this subject is not addressed realistically, the likely result of the unavailability of insurance is that American companies will have to forego participating in all but mundane "off-the-shelf" trade.

A PROGRAM OF GOVERNMENT SPONSORED INSURANCE SHOULD BE ESTABLISHED UTILIZING EXISTING PROGRAMS IN EITHER EX-IM OR OPIC

We are pleased to see that Senator Dodd, recognizing the dilemma companies like ours face, has proposed in S. 1568 establishing a government sponsored insurance program within the Department of Commerce. Increased exports are a goal of this Government. Senator Dodd's proposal will help remove one substantial barrier to this goal. We strongly urge that this proposal be given serious attention by the Subcommittee and that it be put before the full Congress.

To facilitate this, we would like to suggest a few modifications to the Senator's proposal. First, we believe insurance should be provided against restrictions imposed under IEEPA as well as against restrictions imposed under the Export Administration Act.

Second, S. 1568 would limit a company's potential recovery to the total of accrued premiums paid into a fund by those insured. While this proposal has some appeal in this difficult economic time designed as it is to limit the Government's out of pocket liability, we question whether exporters would risk subscribing to it. The principal

reason is that first users basically would be self-insuring. If, for instance, Ingersoll-Rand had a potential twenty million dollar project in the Soviet Union, normal premiums would run from 2–4 percent of the contract price. If Ingersoll-Rand were the first to subscribe, its maximum recovery would be $800,000 based on a 4 percent premium. Indeed it would take 15–20 projects of this size before the first several companies who subscribed could hope to recover their costs.

Rather than limiting the recovery to paid-in premiums, Senator Dodd's proposal to have the Department of Commerce administer the program offers another effective possibility. Our concept has been that insurance would be offered only on those contracts which already had received a validated license or which had received written confirmation from the Secretary of Commerce that the product was shippable under a General Destination license. This review by the same agency administering the program would assure that insurance would only be offered on those projects which had the approval of that agency. We think this review itself would limit the Government's potential liability and permit the fund to build.

Finally, we suggest it would be more effective to require utilization of already existing government insurance programs thereby insuring an exporters ability to make an adequate recover. The insurance program we favor could best be handled by authorizing the Export-Import Bank to expand its political risk insurance program to all countries or perhaps by extending the jurisdiction of the Overseas Private Investment Corporation (OPIC). Both of these organizations have a sound foundation in political risk insurance and could offer it without establishment of a substantial new bureaucracy.

Under our concept either Ex-Im or OPIC would also build a fund through premium payments but would be able to cover an exporters entire loss under present programs while the pool is building. We also suggest that this program be open not only to the exporter but also to the exporter's suppliers who also may be damaged by export restriction.

CONCLUSION

Too often the blame for the United States' severe balance of payments deficit is placed on American industry which is said not to have kept pace with the technological improvements of foreign competitors. But the Government's use of selective controls plays a part in our inability to export in sensitive trade areas.

A program of political risk insurance along the lines proposed by Senator Dodd minimizes the unintended impacts of these controls. We ask only that the Government recognize the effect of its policies and establish an insurance program so that we can again compete in the market and keep Americans working.

Thank you.

Senator HEINZ. Mr. Seccombe, thank you. We are going to recess until Senator Dodd can come back and restart the rest of the hearing. He should be here in a few minutes. I have to go to the floor and vote.

[Recess.]

Senator DODD. The subcommittee will come to order.

We apologize to all of you. Most of you here are probably familiar with the great efficiency with which we conduct business in the U.S. Senate and we apologize to you for this running in and out.

When I left you were still testifying, Mr. Seccombe. Why don't you continue with your testimony?

Mr. SECCOMBE. I completed my testimony.

Senator DODD. You did. Thank you very much.

Mr. Newman, we are delighted to hear from you and again let me express my gratitude to you for coming down from Hartford today to be with us. I don't know what instructions Senator Heinz left, but if you care to paraphrase your remarks they will certainly be included in the record in full and do whatever you feel more comfortable with.

STATEMENT OF WILLIAM O. NEWMAN, GROUP COUNSEL, MACHINE TOOL SYSTEMS GROUP, LITTON INDUSTRIES, HARTFORD, CONN., ACCOMPANIED BY JAMES H. MACK, ESQ.

Mr. NEWMAN. Thank you, Senator.

[Summary and complete statement follow:]

STATEMENT BY WILLIAM O. NEWMAN, GROUP COUNSEL, MACHINE TOOL SYSTEMS GROUP, LITTON INDUSTRIES, INC., REPRESENTING THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

I. INTRODUCTION

Good afternoon, my name is William O. Newman. I am Group Counsel for the Machine Tool Systems Group of Litton Industries, Inc., headquartered in Hartford, Connecticut. Litton is a multinational corporation specializing in products, systems and services for business, defense, marine, professional and industrial markets. Our machine tool divisions manufacture a broad range of automatic grinding and metalworking machines and related equipment. I am appearing today on behalf of the National Machine Tool Builders' Association (NMTBA), a trade association consisting of approximately 287 machine tool manufacturing companies, which account for more than 85 percent of United States machine tool production. Accompanying me today is James H. Mack, NMTBA's Public Affairs Director.

Mr. Chairman, NMTBA is very pleased to be included in the Subcommittee's discussion this afternoon. We appreciate the degree to which both you and Senator Dodd recognize the competitive and financial problems faced by American exporters whose products are subject to the imposition of export controls for national security and/or foreign policy purposes. In that regard, we commend Senator Dodd for his recent introduction of S. 1568, the Political Risk Insurance Act of 1983. NMTBA views S. 1568 as a timely proposal which merits this Committee's careful consideration. As we indicate later in our testimony, however, we do not regard S. 1568 as a substitute for the prohibition against the retroactive application of foreign policy export controls contained in S. 979, which this Committee reported in June. Contract sanctity vis-a-vis foreign policy export controls and the availability of political risk insurance to protect against contract interruptions occasioned by all types of export controls are both important measures; both should be enacted.

Before commenting on the specific provisions of S. 1568, we will focus briefly on the need for export control insurance and the applicability of such a program to the machine tool industry.

II. THE NEED FOR EXPORT CONTROL INSURANCE

NMTBA appeared before this Committee in March to express its views concerning renewal of the Export Administration Act.[1] At that time, we noted the overall decline in U.S. export performance—both generally and specifically with regard to the machine tool industry. We stated our belief that "in certain instances, our government's uneven and often ill-considered application of export controls must be recognized as an impediment (albeit unintended) to the export prospects of those who manufacture and market American products." [2]

We stand by that statement today—which is *not* to suggest that we uniformly oppose the imposition of all export controls. Certainly, NMTBA believes that our nation's ability to maintain a defense-industrial edge over its potential adversaries is absolutely essential. Consequently, we recognize that national security export controls may be necessary when an item would make a direct and significant contribution to the military capability of an unfriendly nation. And while we generally question the effectiveness of using trade as a "weapon," we also recognize that perhaps there are occasions in which it may be appropriate to make international statements of policy by imposing foreign policy controls on selected exports.

However, the point is that in both instances, the imposition of export controls exacts a price from American exporters—a price which is paid in terms of contract disruptions and delays, loss of present and future sales, and of course, the insidious perception overseas that Americans are unreliable trading partners with whom it is simply not worth doing business. With regard to the U.S. machine tool industry,

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[1] *See, generally,* U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, Statement of James A. Gray, President, NMTBA, March 2, 1983 (98th cong., 1st Sess.).

[2] *Id.* at 14.

that price is potentially a staggering one. We would like to share with the Subcommittee why this is so.

First, it is important to note the extent to which export controls directly affect the machine tool industry. Because machine tools have long been recognized as essential to military production, controls imposed for purposes of national security often have a direct and significant impact on our members' ability to export much of the equipment they manufacture. In addition, many NMTBA member companies export to regions which are socially and/or politically volatile, including the Soviet Union and other Eastern Bloc countries, the People's Republic of China, the Middle East and South Africa. As a result, these companies—even those who ship equipment which does not require a validated lincense—are apt to be affected by foreign policy controls. In both cases, export controls can be imposed at virtually any time and without any warning.

Secondly, the machine tool industry is especially vulnerable to export controls because of the way in which American machine tool builders typically conduct business. The bulk of machine tool orders is for highly specialized equipment which must be designed and built to meet a customer's particular needs. The lead time required to fill such orders is often substantial, varying anywhere from six months to two years or longer. (The longer a product's lead time, the greater the likelihood that an export control may be imposed on that product; alot can happen in two years.) Also keep in mind that purchase agreements are frequently written so that payment for the machine is entirely deferred until delivery is made.[3] Thus, should a control be imposed after work on an order has begun, but before the machine has been delivered, our member is left holding the bag.[4] Worse yet, he may be literally stuck with hundreds of thousands of dollars worth of highly sophisticated, custom-designed machinery which cannot be marketed anywhere else.

The presence of these risks, coupled with the fact that they are largely uninsurable, has undeniably altered marketing behavior throughout the U.S. machine tool industry. Many NMTBA members report that they are no longer seeking bids for overseas business in certain areas because the export control risks associated with those areas are just too great. For example, one NMTBA member—a manufacturer of numerically controlled horizontal and vertical machining centers—recently noted that the South African market is "a major opportunity that we are just not going after." He acknowledged that his company "tends to shy away from doing business in any area which tends to attract export controls." As a result, he said, the company confines its business primarily to Western Europe.

Another member expressed a reluctance to seek business in Hungary, which he termed "an otherwise promising market but for the export control problem. You just never know what's going to happen." He also offered the following observation: "Anything that will take some of the uncertainty out of exporting will foster exports. Insurance against export controls would help stabilize what is currently a very uncertain situation."

Mr. Chairman, if U.S. machine tool builders are to remain a viable competitive force in the world market, they simply cannot afford to side-step potentially lucrative marketing opportunities—opportunities which are lost to competitors who do not have to look over their shoulders at their own governments. Clearly, insurance coverage offering American exporters some protecton against government-imposed export controls has become a competitive necessity. Unfortunately, as Senator Dodd has recognized, such insurance is not readily available on the commercial insurance market.

While it is true that a number of sources currently offer insurance coverage against certain "political risks," such coverage usually extends only to those risks associated with the actions of foreign governments. For example, the Overseas Private Investment Corporation (OPIC), a quasi-governmental entity created by the Foreign Assistance Act of 1969, is one of the largest underwritters of "political risk"

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[3] In fact, this practice is increasing and is directly attributable to the "unreliability" factor we mentioned earlier. An overseas customer is understandably reluctant to pay even partially in advance for a machine which he (correctly) has reason to believe may never be delivered.

[4] One of the most celebrated cases to occur under these circumstances involves an NMTBA member company, the Bryant Grinder Corporation. In the early 1960's, Bryant applied for and was granted an export license to ship bearing and race grinding machines to the Soviet Union. The machines were literally on the U.S. dock awaiting shipment when the license was revoked in 1962 for national security reasons. Fortunately, the U.S. government purchased the equipment (which we understand remains inventoried today) from Bryant, so the company did not have to absorb that loss. However, the government's action was on its own initiative, taken solely at the discretion of the Kennedy Administration. There is no assurance that it would be repeated were a similar incident to occur today.

insurance. However, OPIC's statute authorizes it to insure only the following "risks": an exporter's inability to remit funds on a sales contract denominated in local currency; loss of investment due to expropriation, nationalization, or confiscation by action of a foreign government; or loss due to war, revolution or insurrection. Further, OPIC's close ties to U.S. foreign policy objectives leave other gaps in its coverage—for example, OPIC, for a number of reasons, is limited geographically and cannot insure projects associated with most Eastern European, Middle Eastern and Andean Pact nations.

Lloyds of London, by far the largest single private provider of "political risk" insurance, is also one of a very few companies which includes export controls in its political risk coverage.[5] Indeed, my own corporation's experience with Lloyd's illustrates the dilemma faced by many American exporters seeking insurance coverage against losses occasioned by export controls.

In 1976, one of Litton's machine tool divisions was granted a validated license to ship some highly specialized equipment to the People's Republic of China. The equipment was valued at $962,000 dollars. Lloyds agreed to insure the shipment against the imposition of export controls and assessed the company a premium of $22,500 Lloyds also required the company to automatically absorb, off the top, ten percent of any loss. Fortunately, the contract was completed on schedule, so the company's out-of-pocket expenses were limited to its payment of the rather substantial premium. But had the shipment been subject to a last minute export control, the company would have been out $118,700 dollars[6]—a staggering 12.3 percent of the purchase price.

Three years later, following the Soviet invasion of Afghanistan, we again sought export control insurance from Lloyds. The project involved approximately seven and one-half million dollars worth of machine tools destined for the Togliatti automobile plant in the Soviet Union. Lloyds quoted a premium of ten percent—roughly $750,000 dollars. The company balked, deciding that a premium of that magnitude was just not affordable. There was no choice but to proceed uninsured. Again, we were fortunate—the shipment eventually went through without complications. In the meantime, however, millions of dollars worth of equipment hung in the balance.

Our experience with Lloyds helps illustrate the American exporter's dilemma, a perennial "catch-22": export control insurance, when it is available, often means very steep premiums[7] for less than complete coverage. Many times such insurance is simply unaffordable. Yet, the alternative—that is, "running bare"—hardly seems an alternative at all. That is why Senator Dodd's proposal is such a timely one; indeed, S. 1568 provides the framework for an alternative that American exporters have been waiting for.

III. THE POLITICAL RISK INSURANCE ACT OF 1983

S. 1568 authorizes a voluntary, self-financing program of insurance against losses brought about by national security or foreign policy controls imposed under Sections 5 and 6 of the Export Administration Act (E.A.A.). The Secretary of Commerce would have broad authority to establish the program, which would be administered through the Department of Commerce. The bill limits DoC's liability to the total of accrued premiums and investment income.

NMTBA welcomes S. 1568 as a measure which could potentially narrow the rather wide coverage gaps which characterize the export control insurance market today. We do not, however, view the bill as a substitute for the contract sanctity provision approved by this Committee during its mark-up of the E.A.A. last month. (At that time, we strongly endorsed the Committee's decision to prohibit the use of Section 6 of the E.A.A. to abrogate contracts already in force when the President imposes foreign policy controls.) Rather, we view S. 1568 as a necessary addition to the contract sanctity protection now included in S. 979—a protection which extends only to foreign policy controls. Under S. 979, the imposition of national security controls could still result in substantial losses to the American exporting community; S. 1568 could help offset those losses.

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[5] Although we understand that the American Insurance Group's Political Risk, Incorporated now offers coverage extending to export license cancellations which result in an exporter's inability to fulfill the terms of the sales contract, none of the NMTBA member companies surveyed for this statement were familiar with the program. It is not clear from AIG's literature whether its policies extend coverage to all geographic areas at an affordable price.

[6] A figure which assumes that the company was unable to market the equipment elsewhere.

[7] There are "hidden" costs as well. For example, we understand that Lloyds typically requires that all questions concerning its insurance coverage be resolved by English law. Consequently, all disputes arising under its contracts are subject to arbitration in London.

In addition, even if this Committee's contract sanctity language is included in the final version of the E.A.A., the President still has authority to impose foreign policy controls that would require the breaking of existing contracts. In certain emergency situations, such action could be taken under the International Emergency Economic Powers Act (IEEPA). We suggest, therefore, that this Committee may wish to consider amending S. 1568 so that its coverage would extend to exporters who sustain losses resulting from foreign policy controls imposed under IEEPA. Amending S. 1568 in this fashion appears entirely consistent with Senator Dodd's concern that American exporters be afforded protection against control-related losses.

We also suggest that S. 1568 be amended to make clear that insurance coverage would also be available to those companies experiencing indirect losses due to the imposition of export controls. Indirect losses would include, for example, losses actually suffered by a subcontractor whose sale is contingent upon the prime contractor's ability to export. Depending on how far along the production process is when the control is imposed, these losses can range from pre-manufacture engineering expenses all the way to the cost of a completed machine.

Such losses can be substantial, as one NMTBA member company learned through its involvement with Caterpillar Tractor. In 1981, Caterpillar contracted with the Soviets to provide pipe laying equipment for construction of an oil pipeline to Western Europe. Our member agreed to supply Caterpillar with certain machine tools which would be used in the construction of the pipelayers. Declaration of martial law in Poland in late 1981 resulted in foreign policy sanctions against the Soviet Union, which prevented the pipelayer shipment from going through. Consequently, our member, whose equipment was not directly subject to the controls, conservatively estimates that it lost "a couple of million dollars."

We support subsection (g)(3) of S. 1568, which authorizes the Secretary to enter into reinsurance agreements with private insurance carriers. We recognize that this flexibility will enable those exporters who participate in the program to receive more coverage for their premium dollars. We also believe this provision reflects Senator Dodd's acknowledgment that the bill is not intended to compete with or establish a basis for the regulation of private insurance providers. Hopefully, reinsurance agreements will provide an avenue for greater private carrier involvement in the export control insurance market.

Finally, we are mindful of the fact that some have pointed to the proposal's apparent irony—that is, the government acting in the role of "insurer" against its own actions. NMTBA views this feature of S. 1568 as appropriate and fair. As we have already noted, the government's imposition of export controls costs American exporters a great deal. It strikes us as eminently reasonable, therefore, that the government should assume at least part of the responsibility for those costs. (Although because S. 1568 limits the government's liability under the program to the total of accrued premiums and investment income, the government's "responsibility" is arguably minimal.) In that regard, we endorse Senator Dodd's view that "the frequency with which we impose controls, and the magnitude of the losses associated with those controls, require that we do what we can to protect American exporters from adverse financial consequences."

IV. CONCLUSION

NMTBA recognizes that not all export control-related losses are compensable—particularly those linked to future sales (including replacement parts) and the "unreliability" factor. However, this does not suggest that we should not continue to seek the most effective remedy for minimizing such losses. Clearly, the need for available, affordable export control insurance has never been greater. We believe that Senator Dodd's proposal represents a sizable step toward filling that need, and we urge this panel to give its prompt and favorable consideration to S. 1568.

Thank you. We would be happy to respond to your questions.

Senator HEINZ. Mr. Newman, thank you very much.
Mr. Schinkel.

STATEMENT OF THOMAS SCHINKEL, PRESIDENT, THOMAS SCHINKEL & ASSOCIATES, LEXINGTON, MASS.

Mr. SCHINKEL. Thank you, Mr. Chairman.
[Complete statement follows:]

STATEMENT OF THOMAS SCHINKEL, PRESIDENT, THOMAS SCHINKEL & ASSOCIATES AND THE BOSTON VENTURE FUND, INC., BOTH OF LEXINGTON, MASS., REPRESENTING THE SMALLER BUSINESS ASSOCIATION OF NEW ENGLAND, INC., OF WALTHAM, MASS.

Mr. Heinz, members of the subcommittee, and audience:

1. Thank you for inviting me. My name is Thomas Schinkel, president of Thomas Schinkel and Associates and the Boston Venture Fund, Inc., both of Lexington, MA. Both actively engaged in export assistance to smaller high technology manufacturers and service companies in New England.

2. I appear before you as a member of the International Trade Committee of the Smaller Business Association of New England (SBANE), headquartered in Waltham, MA. SBANE is a member of Small Business United (SBU), the Nation's coalition of small business organizations.

3. Mr. Chairman, there has been a barrage of Government actions in the recent past all focusing on efforts to strengthen the U.S. export position in general and small business exports in particular. Examples include SBA export loan programs, the Export Trading Companies Act of 1982, efforts of the Ex-Im Bank to reach out to small business, and the private overseas investment corporation.

4. Yet, there are strong forces at work causing small business to lose ground in overseas markets which had been gained during the late 1970's. Much of this is caused by (the absence of) a monetary policy to keep the dollar exchange rate within reasonable parameters against other currencies. Many small exporters have lost up to fifty percent and more of their export gains and this has happened in a time span of less than eighteen months!

5. Supply side economics dictates the slashing of Government budgets for direct export promotion at the time when this sort of stimulus is needed more than ever. Local content proposals threaten to further ignite retaliatory actions by the governments of major overseas countries for protectionistic policies on their side. The same observation is valid for local content proposals which surface from time to time. Proposed DISC legislation will take away a tax incentive for exports by small companies.

6. Mr. Chairman, we are witnessing Government policies which seem to contradict each other and which tend to neutralize and eventually minimize all efforts by the Government and the private sector to build a strong economy based on substantial exports overseas.

7. Therefore, SBANE is generally in favor of a comprehensive and coherent long range international trade policy which takes advantage of every legal opportunity to stimulate and facilitate exports by small companies. Small businesses are often amongst the most innovative companies making a strong and meaningful contribution to the well-being of this country through job creation and earnings from exports.

8. In this context, SBANE would favor the utilization of export controls as an instrument of international trade policy only in the most extreme of circumstances. SBANE shares Senator Dodd's view that the U.S. has used the export controls instrument more often already than any of its major trading partners and allies.

9. SBANE believes that Senator Dodd's bill introduced before the Senate generally is a positive step towards a coherent international trade policy as referred to previously, facilitating and stimulating small business exports and minimizing the risks for small business resulting from export policy controls.

10. Yet, SBANE likes to express reservations against this sort of legislation for both political and practical reasons.

11. First the political reason. SBANE's concern is that this very attempt to introduce instruments for political risk insurance will open the door for a gradual proliferation of export controls, utilizing the argument that exporters now have an instrument to reimburse them for loss of sales in export markets resulting from these controls.

12. Second, on a practical level, SBANE believes that the risk accumulation of a program advocated by Senator Dodd could not be sufficiently covered by accrued premiums and income from investments of a fund to be set up for this program.

13. A provision which would allow claims to be restricted to the premiums paid-in would seriously restrict the benefits of such a program to such an extent that this restriction would cause the program to fail in the very early stages of its implementation. SBANE expresses its doubt as to whether such a program could be self-funding during the early years of its implementation.

14. SBANE has not made a detailed study of any programs currently available in the private or public sector in this country or overseas which cover the risk associated with the loss of sales and the loss of profit resulting from the imposition of

export controls by the government of the exporting country. Therefore, a discussion of terms, conditions and claims review processes must remain conceptual.

15. Yet, SBANE expresses concern that claims review processes of this nature have a tendency to add additional layers of administrative paperwork to the workload of small companies and there is a genuine concern that the very problem of export controls discourages small companies from marketing efforts overseas.

16. It would also be beyond SBANE's role to collect, provide and disseminate information as to the degree to which countries abroad provide similar insurance. SBANE believes that there are adequate sources of information within the Government to provide the committee with such information in a nonpartial and unbiased fashion.

17. SBANE would like to stress the point however that the costs associated with loss of sales overseas resulting from export controls by the U.S. Government reach far beyond the direct loss of a sale to a particular customer in a particular country.

18. The risk of such a loss includes the investment made to get the customer in the first place, the overall credibility of a company's export program, its long-term success potential in markets not directly affected by controls, the risk of a foreign competitor stepping in to fill the void left behind by the American company, and the fact that once a sale is lost it closes the door to such a customer in such a country for many years to come if not forever within the context of a particular product/market scenario.

19. In this respect it is subject to doubt whether losses of sales resulting from export controls can be adequately measured by the customer-invoice only. Also, the voluntary nature of such a program would sharply curtail the fund in its ability to provide claims payments under the program of political risk insurance.

20. In fact, this principle of voluntary participation would seem to be a violation of the insurance principle since the voluntary premiums would per definition be collected for sales to high risk countries. Hence, there would be no obligation for exporters to pay premiums on sales to countries against which the likelihood of these U.S. export controls would be minimal.

21. In summary, SBANE suggests to follow the example of trading partners such as W. Germany and reduce the utilization of export controls to an absolute minimum. This is in line with SBANE's review of a consistent and coherent long term international trade policy which takes every opportunity to stimulate and promote small businesses' ability to build dominance in their respective world markets.

22. While SBANE expresses its appreciation for the intentions underlying this particular bill, it has political and practical reservations against Senator Dodd's bill in its present form before the Senate as outlined in this statement. SBANE and its international trade committee offer their cooperation and assistance to the committee, if so desired, for further evaluation of the concept of political risk insurance as envisioned by Senator Dodd.

23. Thank you for the opportunity to present SBANE's views before your committee.

Senator HEINZ. Mr. Schinkel, thank you very much.

COUNTRY AND EQUIPMENT DETERMINE INSURANCE RATES

Mr. Seccombe, let me ask you, the Export-Import Bank through its affiliate, the Foreign Credit Insurance Association, provides preshipment insurance.

Why is that kind of insurance, apart from the fact that it clearly is not available for the Soviet Union and some other Eastern bloc countries, not on the Eximbank approved list, why is that kind of insurance not sufficient for the purposes you advocate?

Mr. ISRAEL. Senator, we think that that insurance would be sufficient for the problem that we have but for the Jackson-Vanik problems. In fact, you will see in our proposal that we would have insurance offered through Exim but something has to be done about the Jackson-Vanik problem.

Senator HEINZ. Then that is the heart of your problem?

Mr. ISRAEL. It is, yes.

Senator HEINZ. What is the cost of that insurance to non-Jackson-Vanik excluded countries now?

Mr. SECCOMBE. I guess, Senator, I'm not prepared to answer that because recently we haven't checked that because our concern is of course toward the job that we're talking, reaching the Eastern bloc countries. Maybe the insurance people could better answer it, but I would guess somewhere between 1.5 and 2 percent.

Senator HEINZ. Well, as Senator Dodd suggested, there are a number of questions we should address to FCIA. That will be one of them, together with an indication of the extent to which that program is, as we say, actuarially sound whatever we mean by that concept.

Would you expect to pay a higher premium for shipments to the Eastern bloc than you would to non-Eastern bloc countries?

Mr. SECCOMBE. I think so. It's assessed on the risk and we found that in our own case the first shipment we made to the Soviets that was embargoed, the risk, as it was assessed at that time, the insurance cost was reasonable. In later requests for insurance, even when it was considered, the rates became totally unreasonable, as suggested by Litton.

Senator HEINZ. Apparently, Mr. Newman, while I was making my way back from the floor, you testified that—correct me if I'm wrong—Lloyds of London has offered your company a 10-percent rate.

Mr. NEWMAN. Yes. We never negotiated it to the end, you understand. I don't know whether that would have stayed in place all the way through or not.

Senator HEINZ. Let me ask Mr. Seccombe, would 10 percent be too high a premium, too high a price to pay?

Mr. SECCOMBE. I believe 10 percent is getting unreasonable because that's a cost that has to be included in your price and we've run into that problem. If the insurance is available and the cost is too high, then you become noncompetitive anyway because we're competing against European competitors who have the availability of government-sponsored insurance at a much better rate.

Mr. ISRAEL. Excuse me, Senator, but our problem with Lloyds and with the others within the last 90 days hasn't been a 10-percent premium. We have gone out to them on the projects we described in our testimony and there is no insurance available at any premium.

Senator HEINZ. Currently?

Mr. SECCOMBE. Right. In fact, the same project that Litton was able to receive insurance on for Togliattigrad, Ingersoll-Rand could not acquire insurance from either the domestic market or the London market.

Senator HEINZ. Are you suggesting that Litton is a larger conglomerate than we ever expected?

Mr. SECCOMBE. No. I think one of our problems was we had one embargoed on the type of equipment we were proposing and the risk is quite great because the equipment is absolutely worthless—there's no residual value to it—and therefore, we could not acquire it. We even tried two of the Russian insurance companies and they weren't interested.

Senator HEINZ. No luck?

Mr. SECCOMBE. No.

Senator HEINZ. Would you expect this kind of insurance to Eastern bloc countries to vary in terms of its premium in accordance with the kind of equipment involved?

Mr. SECCOMBE. I would think so, yes. I think it would have to depend on the risk involved. For instance, Ingersoll-Rand today can buy political risk insurance for some products. We can't buy political risk insurance for our special engineered product, custom-designed product.

Senator HEINZ. And I assume that when we're talking about political risk insurance we are really talking not about convertibility, not principally about lost sales due to contract abrogation. Is that what we all mean by that? The term political risk has over the years been stretched to include a larger number of ideas.

Senator DODD. Mr. Chairman, this bill is just for export controls. That's the only thing covered under this bill.

Mr. SECCOMBE. Yes.

Senator HEINZ. And the abrogation of contracts as opposed to a claim that a sale was lost because of the imposition of controls—I understand that is Senator Dodd's intent, but I want to make sure that your intent is the same as his.

Mr. SECCOMBE. Your assumption is correct.

CONCEPT OF PROGRAM GOOD; SOME PROVISIONS WEAK

Senator HEINZ. Now what is the price or the cost of the insurance available to European national companies or domiciled companies? Do you have any information on that?

Mr. SECCOMBE. I might have that in my file. I'll look.

Senator HEINZ. It would be helpful to have that. My suspicion would be that in many cases it's probably subsidized.

Mr. SECCOMBE. I don't know, sir. When I checked, the last time I checked, it was comparable to the cost that I had paid from the private industry.

Senator HEINZ. Well, we would be interested in any information you have and the extent to which you are able to determine whether or not their insurance programs are actuarially based and sound. I assume you favor an actuarially sound system?

Mr. SECCOMBE. Absolutely.

Senator HEINZ. Within the common everyday meaning of the term?

Mr. SECCOMBE. Yes. I think we understand what that means.

Senator HEINZ. Very well.

Let me ask Mr. Newman—you said that you did not believe that such insurance would be a substitute in any way, shape, or form for the contract sanctity provisions of the Export Administration Act. Is that correct?

Mr. NEWMAN. That's correct.

Senator HEINZ. Now, on the other hand, you have gone on record in support of the concept of Senator Dodd's bill.

Would you support an amendment to the Export Administration Act by Senator Dodd or someone else of his concept to the bill?

Mr. NEWMAN. Well, we are grateful to Senator Dodd for recognizing the problem, but it seems to me that S. 1568 is in a very

preliminary stage, a proposal that needs further consideration. As such we would not be in a position to propose to support it in its current form.

Senator HEINZ. Well, could you be a little more explicit as to your reasons for believing that this would be premature?

Mr. NEWMAN. Well, some of the provisions cause us some considerable concern and we would like to see some further analysis of them. For example, limiting the insurance fund to accrued premiums, could actually work to an exporter's detriment; he might feel that he had insurance coverage that he didn't actually have. That is one of our concerns.

Also, the bill does not make clear what losses are covered. For instance, the bill doesn't specifically address existing contracts.

Senator HEINZ. Would you support an amendment that told the Commerce Department to report back to us within 6 months with at least one workable program and maybe some variations on it?

Mr. NEWMAN. Yes, we would, provided it wasn't used to replace the contract sanctity provision.

Senator HEINZ. Very well.

Now, Mr. Schinkel, you have opposed this program.

Mr. SCHINKEL. Not so much opposed the concept, but more the details and the details of the way the bill is on the table today.

Senator HEINZ. Well, Senator Dodd's bill is very broad. It really tells the Secretary to establish a program. Why isn't the breadth of the mandate sufficient flexibility to the Secretary to develop, as he says in section 2 of the bill, an actuarially sound program? What's your problem with that?

Mr. SCHINKEL. The problem that especially smaller businesses have in their dealings with the eastern European countries and the countries which are subject to export controls is that their overall problem with exports is that they see a situation where, because of a number of other government actions, they have been seeing loss of market share in their more important markets rather than in the incidental, almost everyday activities in Eastern Europe. They feel that there might be a possibility, if you will, to support them in their ability to gain exports or to regain exports, that there may be tools in an entirely different area of trade policy rather than this particular one.

Senator HEINZ. I'm going to ask one last question and then turn the rest of the questioning of your panel over to Senator Dodd, and I will hold the vote for him.

Mr. Seccombe, one last question. Were this to be placed on an actuarially sound basis, one of two things would happen. It would seem to me that either the initial premiums would be exorbitantly high and therefore ineffective, or that initially in order to keep the premiums reasonable there would be a temporary, if recoupable, subsidy.

How would we justify what would be, albeit a temporary one, nonetheless a subsidy of trade to eastern European nations?

Mr. SECCOMBE. Well, I think everyone is very concerned with the amount of exports of this country. I think we would have to recognize that this would definitely encourage the export business. I know what kind of effect it could have on my business. My business could increase by 30 percent if this was available to me. I

think the machine tool industry itself would experience a tremendous increase in export business, and I guess that's the way you would have to justify it.

If we are interested in increasing our export trade, I think the numbers bear it out, that the——

Senator HEINZ. I understand the arguments in favor of it. I need to turn this over to Senator Dodd. The question, though, which we might just all reflect upon, because I think it is really a political question. We have, all of us, almost to a man, complained to the Europeans about subsidizing the building of the pipeline. We have complained about the Europeans subsidizing all kinds of export credits, not just to the Soviet Union, but all over the world. We have gone to all kinds of lengths to try and negotiate better arrangements and so on and so forth. And there's a real consistency problem which can only be justified as being kind of temporarily pregnant, if you will, in our having in the short term subsidies for these countries.

Senator Dodd.

Mr. ISRAEL. Senator Heinz, before you go, one thing. When you came in earlier, you suggested that the availability of this insurance might encourage the use of export controls. That hasn't been our experience. I was involved when NBC was embargoed in the 1980 Olympics and then with Ingersoll-Rand and then with the pipeline.

The administration never went to any of those businesses and asked whether they had insurance. When we went to the White House afterward to try to get the restrictions lifted, they asked us if we had insurance. I don't think it's part of the decisionmaking process.

Senator HEINZ. Thank you.

ADD THIS INSURANCE PROVISION TO HOUSE BILL

Senator DODD. Let me repeat to all of you, that as I mentioned at the outset, I'm not wedded to every single provision here. This is more of a conceptual effort because I recognized and have raised myself many of the questions you have raised and more about various parts of this that I have suggested. The FCIA is a possibility of doing something, but there are problems with FCIA in terms of solvency right now which I think most of you are aware of.

At any rate, I appreciate your endorsement of my effort in this area.

I have a couple of points if I could. First of all, Mr. Seccombe, in your testimony—and I agree with it—you say that the inability to obtain political risk insurance is not a problem that hinders our competitors in allied countries. While other nations have a political risk insurance to cover this kind of situation we do not have similar programs. We exercise export controls with far greater frequency than our competitors. They have political risk insurance programs and we don't. So it would seem if you followed the argument against the proposal on that basis, then in fact those countries with programs should be using export controls more frequently, and they're not. So that argument does not hold much water.

In your statement, Mr. Seccombe, you agree on the need for export control insurance regardless of what happens to contract sanctity. If the Export Administration amendments are passed as they are, national security controls could include interruption of existing contracts, as could controls under the International Emergency Economic Powers Act. In the House reported language, sanctity could be broken in the case of terrorism, aggression, human rights violations, and nuclear weapons tests. That was an amendment offered by Congressman Berman in committee. Whether or not that will hold up on the floor is another matter, but at least that's what was reported out of the committee.

The administration would permit breaking of sanctity of contracts with a delivery time of over 270 days or in the case of the overriding national interest.

I wonder if you might offer any suggestions to this committee. Granted, we reported out a bill already, but I suspect there's going to be an effort to try to strike a balance between the House and Senate bills.

Do you have any suggestions as to what we might offer as an alternative ground to those two positions?

Mr. SECCOMBE. I might make a comment and then maybe Mr. Israel wants to follow up on that.

The 270 days would be a big problem in our industry. As mentioned, our contracts are usually 12, 18 to 22 month contracts, and if we were 3 months into a contract and had 270 days to complete it and get it shipped, that would offer us no protection at all. So we have a great concern about that kind of language in the bill.

Mr. ISRAEL. I can't help you on the specific language. It depends on what your philosophy is on export controls. If your philosophy is the President's hands ought not to be tied, you've got to give him some way out. If you want to tie the President's hands absolutely, then you need to have an absolute proposal.

Senator DODD. Have you seen the House language?

Mr. ISRAEL. Yes, I have.

Senator DODD. What do you think of it?

Mr. ISRAEL. I think it gives the President all he needs to get out of this. In working on the Ingersoll-Rand problem and on others, in looking at the President's authority under section 5 and 6 of the Export Administration Act, once he's got something he can put his hat on, some tolerable argument that he has a legal authority to suspend a contract, he's going to be able to use that authority and I don't think anybody is going to be able to challenge him. Dressler tried to challenge the President's extraterritorial control both in courts and in the Department of Commerce and they were spectacularly unsuccessful. They got nowhere because he had something to hang his hat on.

The House gives the President a way out if it's in the overriding national interest.

What we would like to see done is add this insurance provision to the bill and that would go a long way toward solving our problem.

Mr. MACK. Senator, I've also looked at the Berman amendment and in our view, it really provides an exception or a series of exceptions that swallows the rule. I can't imagine a President who would

impose export controls for any reasons other than those listed in the exceptions.

It seems to us that if you're going to effectively handle excesses of authority under foreign policy controls, the way to do it is the way that the Senate Banking Committee has provided.

That still, as Mr. Israel has suggested and as we suggested in the testimony, leaves a very substantial problem because the President still has authority under IEEAPA and he has authority to impose controls for national security purposes.

Consequently, we have suggested that S. 1568 be expanded to include IEEPA in its provisions. I think that our reluctance in suggesting that the proposal, in its current form, be included in the E.A.A. bill, is that it may well be that as you and Senator Heinz and perhaps others in the Senate are able to spend some more time on it, what is an excellent idea can be made better and more workable.

Senator DODD. Let me just say, as a practical matter, we don't have a lot of time. This bill is going to go to the floor soon. You have already seen what the House committee has done. You know what this committee has done.

I would presume—and normally this is the case—the committee provision will prevail on the floor of the House, which means there will be a watered-down version of what you presently like in the Senate bill.

It seems to me that from your perspective, at least based on your testimony, there's going to be a greater sense of urgency about doing something here.

Mr. MACK. What I'm suggesting, Senator, is that at the same time there is a sense of urgency, the proposal in its present form is not an idea whose time has yet come—but it needs to come quickly. I agree with you that perhaps it can be put into an acceptable form by the time you get to the floor, but in our view, it is not in such a form right now. But it is an excellent start and I think this hearing will help to develop that kind of consensus.

Senator DODD. I'm going to beg your indulgence because I'd like to finish up and I only have a few more questions, but if I miss this vote I'll be in trouble.

I should point out that I appreciate your testimony and taking the time to come here.

One of the cases you cited was the ballbearings in 1962. I should point out to you that the person who raised that issue at the time was a fellow by the same last name as mine. He was the one that stopped that shipment. It's intriguing 20 years later—I just make note of that.

I will come right back and recess for a few minutes and come right back. I apologize again.

[Recess.]

Senator DODD. I would like to call this hearing back to order. I'm told that that may be the last vote. As Senator Heinz said to me before he left, we are being shelled today.

Mr. Seccombe, I will address this to you. I presume that since I'm from the insurance capital of the world, Hartford, Conn., some may have thought that I should have examined this more carefully before suggesting enactment of public political risk insurance. But based on the information I've heard—and I think we will hear some more on it a little bit later—in those countries around the world that do have a public political risk insurance program, there are also very aggressive and active private insurance programs that I'm told have not suffered as a result of this kind of situation.

At any rate, exports are, as you have all pointed out, so crucial to our economy—and I might add, in Connecticut, we are the single most dependent State on a per capita basis on exports. There are other States larger than ours with more total volume in dollars, but in the State of Connecticut we are the most dependent of all the States.

Now a little later we're going to hear from AIG and they are basically going to say—and obviously they will say it themselves—that they offer insurance very much along the lines that I'm advocating in this legislation.

Yet, Mr. Seccombe, you say you can't get insurance. Did you ever go see AIG for your insurance?

Mr. SECCOMBE. Yes, sir, we have.

Senator DODD. What happened?

Mr. SECCOMBE. At least twice in the last 2 years we surveyed the entire domestic market, also the London market and, as I mentioned, even the Soviet market, and been unsuccessful on both occasions and that's when we elected to withdraw from the Togliatti project and also one in East Germany.

Our problem wasn't just the Soviet Union. It was also East Germany, and on that project we even tried to work it out where we could work with Citroen and Renault as a subcontractor and therefore we would acquire insurance for them, but on the other hand, we still couldn't acquire it because they knew that the ultimate customer was East Germany and if the U.S. Government said, "Don't ship," we, as Ingersoll-Rand, would not ship.

Senator DODD. So it wasn't a question of premium cost. You just couldn't get it?

Mr. SECCOMBE. On one occasion we first received a somewhat positive response from Lloyds, and the premium and the deductible when they came back with that it was totally unreasonable, and then before we made a decision on that, they came back and withdrew their offer altogether.

Senator DODD. Was that the one for $750,000?

Mr. SECCOMBE. No, that was for $20 million.

Senator DODD. What was the premium cost?

Mr. SECCOMBE. The premium cost was 10 percent, but then they were suggesting a deductible of 50 percent.

Mr. ISRAEL. Senator, we did this most recently in April and went to the domestic market and the foreign market and the thing we found in the domestic market was that not only was insurance not available but they were willing to give us insurance against Rus-

sian cancellation but not against American cancellation of the contracts.

Mr. MACK. Senator, I have had some experience in another piece of legislation that affected our members in terms of the unavailability or unaffordability of insurance on the product. At that time, when it was suggested that insurance was not available and not affordable, we would have a hearing like this and the whole audience would be made of insurance carriers and insurance agent groups arguing that we were wrong. They are not here today and I have talked to some of the insurance carriers and some of the insurance agent groups and they indicate that on this particular matter, they are not concerned because they don't currently offer export control coverage. That has been the experience of our members as well.

I think that you can look at who isn't here and is not showing an interest in this legislation to determine whether commercial insurance is generally available under these circumstances.

Mr. SECCOMBE. Senator, could I make an observation, and it applies to the machine tool industry which I think is probably the one industry most affected by this.

Senator DODD. Tell me what are the numbers of people in the machine tool industry, for instance? What are the number of people or businesses we're talking about?

Mr. NEWMAN. People employed in the business?

Senator DODD. People employed, number of corporations or businesses that are part of the association?

Mr. NEWMAN. I think the total employment of the machine tool business now is down quite a bit from a few years ago.

Senator DODD. I understand that.

Mr. NEWMAN. But I think it's around 60,000 right now.

Mr. MACK. Normally, Senator, about 100,000 at the peak of the last economic cycle, a little over that. It's now down to about 60,000. According to the Commerce figures, there are some 1,200 companies that occasionally make machine tools or are listed in the Commerce Department figures as machine tool builders.

NMTBA represents about 287 companies which account for 85 to 90 percent of the total shipments in the machine tool industry.

Senator DODD. All right.

Mr. Seccombe, you wanted to make a comment.

CONTRACT COSTS AND RISK INSURANCE FUNDING

Mr. SECCOMBE. The point I was going to make is this industry, when it's working on one of these projects that requires insurance, of a size that requires that type of protection, just to prepare a proposal and negotiate a contract takes anywhere from 3 to 9 months on a regular basis. Now that can be a cost of anywhere from $20,000 to $80,000 to that company to prepare the proposal and begin negotiation.

It's at that time that that company should know that it has insurance available to it and what the cost is. But over that 6-month period, we have found that the cost, whether it's available or not with the private industry, can change dramatically just because of a few decisions made, a few confrontations, what have you. And that's one of the problems we have dealing with the private indus-

try even when it was available. If it's available today, it's not available tomorrow.

That is a very serious problem with our industry and that's one reason we have elected to withdraw from most of this business. Even when we get a somewhat positive answer going in, we're very reluctant to put that kind of investment into going after the project. And one of the biggest problems is that's when you become an unreliable supplier—is at the end of the 6 months when they're negotiating only with you, you say, "I'm sorry. We can't find insurance and we're going to have to go home. Find someone else."

Senator DODD. Mr. Schinkel, you've been rather quiet during this discussion. What has been your experience?

Mr. SCHINKEL. First of all, SBANE has approximately 2,000 members and a total employment in the area of 20,000 people. I would say 20 to 25 percent of these companies today are exporting in some form. Many of them, of course, not to eastern European countries, but several of them do, and especially recently, the way they've responded from a small business point of view, the way they behave, is when there is export controls or when there are problems with insurance, they have a tendency to withdraw or, for example, in one particular case they've gone—for example, even in the event where there was no permission necessary from the Government, they go to a company, for example, in Finland or Austria and they license the production of their technique to these companies and let them worry about the problems. They literally withdraw from the problems of export controls and insurance and so forth because it gets much too complicated.

Senator DODD. Of those that are still doing their production here, what evidence do they offer? Are they able to get insurance from private carriers?

Mr. SCHINKEL. They're not able to get that, no. It's very similar to the situations we've just discussed.

Senator DODD. I should point out, by the way, I am very familiar with SBANE and you do a tremendous job. I have got a number of very close and dear friends who are active in SBANE and you've got an active group in Connecticut.

Mr. SCHINKEL. That's correct. Also, SBANE will make available every cooperation in terms of review of this situation that's necessary.

Senator DODD. All of you have expressed—and I think legitimately—concerns about some of the specific details and we are not in disagreement on that. One of the provisions—and it doesn't take a great deal of imagination to figure out why I wrote it the way I did—requires that the program be self-financing—rather than be funded from the public coffers. I don't need to tell any of you here how that would be received generally. A self-financing program would be funded by premiums paid by participating companies. However, as you have noted, this would be rather difficult when you are trying to get the program off the ground.

Some of you have expressed support for a modest amount coming from the public treasury, given the importance of this issue, and the economic loss we suffered.

I think that was the sum and substance of Senator Heinz' question to you, Mr. Seccombe. Is there an economic justification, a

payoff that would result from having political risk insurance at this time? Would we generate the additional revenues as a result of increased business to offset a public subsidy?

Mr. SECCOMBE. I think it's kind of like the commercial, "Pay me now or pay me later."

Another important point that I think we should consider is the fact that when you insure you usually do not insure the contract value. A $20 million contract is not what you insure. You insure the maximum risk at any time during that contract period, which is always considerably less, especially in our industry, because usually this involves multiple shipments. The Kama job which was embargoed which Ingersoll-Rand had the problem with was insured by AIG, but never was the insurance intended to cover the $10 million value of that job. At the time it was embargoed, the cost was in the neighborhood of $4 million. And so you're not insuring the total contract. The risk is never that great.

Senator DODD. All right. Well, I appreciate very much, and I know the committee does, your testimony today—all of you. We may have some additional written questions for you. Also, if you might take a good hard look at the self-financing provision, and any others for that matter, you are most welcome to suggest improvements. All of you should feel free to contribute to this process and to do so, if you could, sooner rather than later, so that we might present a useful and workable proposal as soon as possible.

Mr. NEWMAN. Thank you. We certainly accept your offer, Senator.

Senator DODD. Also, I just received a copy of a letter dated December 29, 1982, from the President's Export Council addressed to the President of the United States. I will not read the entire letter but I thought you might find this particular paragraph interesting. These are the recommendations. In the first recommendation it says:

> Following the precedent set in the Agriculture and Food Act of 1981, legislation should be enacted which, notwithstanding any other provision of law, would direct the U.S. Government to provide U.S. firms with insurance protection from foreign policy based trade limiting decisions pursuant to the provisions of the Export Administration Act.

I ask unanimous consent that this letter be made a part of the record. I think it's important to note that the President's Export Council in fact made such a recommendation to the President.

[The following letter was subsequently submitted for the record:]

THE PRESIDENT'S EXPORT COUNCIL
WASHINGTON, D.C. 20230

December 29, 1982

Dear Mr. President:

The President's Export Council has been examining a wide range of trade disincentives. Among them is the fact that U.S. manufacturing and exporting firms do not have access to insurance on contracted trade with East-bloc countries (except Hungary and Romania) to protect them from losses caused by foreign policy export controls which interrupt or cancel contract performance.

At the December 16 meeting of the President's Export Council, the following three recommendations concerning legislative initiatives and amendments to existing law relevant to the above issue were passed unanimously.

The first two, which could well be combined into a single piece of legislation, are designed to keep U.S. exporters economically insulated from contractual difficulties caused by the imposition of foreign policy controls by the U.S. Government as a sanctions vehicle:

1) Following the precedent set in the Agriculture and Food Act of 1981, legislation should be enacted which, notwithstanding any other provision of law, would direct the U.S. Government to provide U.S. firms with insurance protection from foreign policy-based trade limiting decisions pursuant to provisions of the Export Administration Act. These provisions now have the effect of terminating or suspending U.S. companies' performance under export sales contracts to any destination. Such coverage could be similar to pre-shipment coverage programs of the Export-Import Bank, Foreign Credit Insurance Organization (FCIA) and Overseas Private Insurance Corporation.

   However, it should be noted that FCIA pre-shipment coverage does not assist with the periods of indecision surrounding the Government's prior practice of:

   a) not processing export license applications for foreign policy reasons;

b) not accepting export license applications for foreign policy reasons;

c) suspending exports under valid contracts for an unspecified period of time for foreign policy reasons, and

d) imposing a validated license requirement for foreign policy reasons.

2) Enact sanctions adjustment legislation through which the Government would provide, notwithstanding any other provision of the law:

a) compensation to U.S. firms that sustained contract penalties and/or other losses as a direct result of the imposition of foreign policy controls;

b) low interest credit facilities up to the value of contracts on which contract performance is suspended, delayed or cancelled by foreign policy controls; and

c) the extension of unemployment benefits to those workers whose jobs are lost as a direct result of the suspension or cancellation of contracts for foreign policy reasons. (Note: a bill along this general line, H.R. 6926, was introduced by Rep. Paul Findley on August 4, 1982. However, it was not as broad as this recommendation.)

The final recommendation is designed to force recognition of the obligation of contracts and would remove the authority of the Government to interrupt performance on contracts signed prior to the imposition of export controls for foreign policy reasons. Based upon the attitudes and opinions collected by the Council's Export Administration Subcommittee from both the legislative and executive branches of Government, this recommendation is, unfortunately, the least acceptable alternative to the recognition of equity in the Government's influence on the industrial sector of the U.S. economy:

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3) Enact legislation to amend the Export Administration Act (Section 6), which grants the authority to "prohibit or curtail the exportation of goods, technology, ... to further significantly the foreign policy of the United States..." so that such authority does not extend to the suspension or restriction of performance under contracts signed prior to any such foreign policy determination. Use of the export licensing process as an alternative vehicle to suspend, restrict or cancel such previously signed contracts when they are for commodities controlled only for foreign policy reasons should be prohibited.

Sincerely,

J. Paul Lyet

J. Paul Lyet
Chairman

The President
The White House
Washington, D.C.

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Senator DODD. We had originally asked Mr. Svensk to testify first, but Mr. Merrett, who's come all the way from London, has a 6 p.m. flight and, with your indulgence, Mr. Svensk, I'm going to ask Mr. Merrett to go first and we will proceed as rapidly as possible and excuse him.

Mr. Merrett, again, our appreciation for being here.

STATEMENT OF STEPHEN MERRETT, UNDERWRITER, LLOYD'S OF LONDON, LONDON, ENGLAND

Mr. MERRETT. Thank you very much, Senator. I'm extremely grateful to be invited to speak to you this afternoon. I won't read my statement because that will be part of the record as I understand it. I would just say from it that I am Stephen Merrett. I'm an underwriter from Lloyd's of London and one of my particular areas of expertise is political risk insurance and has been for more than a decade, that I am a member of the council or committee of Lloyd's, but I attend this session as an individual underwriter as part of that marketplace and not as a representative of the Lloyd's establishment, if I may put it like that without offending anybody.

What I would like to do in the way of the preparatory remarks is limit myself really to expressing what I hope are regarded as friendly views on the difficulties of putting in place a government program such as that suggested by your proposed legislation. I'm sensitive on the point of the line between offering what might be regarded as expert insurance testimony and straying into the area of American domestic political concerns, and if I do transgress that line, I hope you will be kind enough to forgive me.

The problems essentially that I would foresee in the government program as envisaged arise from the, as I understand it and as you have said, the really hypothetical basis on which you put it at this stage in establishing an actuarially sound rating basis. It doesn't appear to those of us who are in the business of trying to assess the rates on risks of this sort that there is an actuarial basis. There is no guideline before the fact which really clearly indicates what the probabilities are in any certain circumstances.

Therefore, we find that particularly on a narrow base which the program would presumably start with, unless it was intended this should be compulsory insurance, that it would be highly unlikely that without very substantial support, either by way of reinsurance, government funding or adherence to some other government insurance agency scheme, that it would be actuarially sound at the beginning.

The second suggestion that I would like to make is that a government scheme of this sort fulfill only with great difficulty the ordinary requirements of a government insurance scheme, that the agency put relatively standard rates to all buyers of its insurance, because, the risks offered would by no means be the same. We believe that the addition to the political pressures on behalf of constituents put upon those attempting to underwrite for the scheme using selective rates to match their estimation of the risks, of pressures for lower rates from all buyers, and of pressure for standard level rates from those buyers whose risks are perceived to be high would be extremely difficult to accommodate.

The third point, and I think the last fundamental point that I'd like to raise relates really to the suggestion that the provision of such a scheme would reduce the enthusiasm of the private insurance market to get into this area to a greater degree than it has done up to now.

I think the effect would be much more, that there would be a great selection against the government pool by the buyers of insurance. They would turn to the government pool as an insurer of last resort. The commercial insurers presumably would be still free to put those risks which they thought were easier to absorb and, therefore the difficulties of the government scheme in providing an actuarially sound basis would be compounded by the selection of risks against it.

There would be other points that I think I would like to make at this stage, rather than in response to any questions that there may be, relate to the individual points that have been raised in the evidence before this stage this afternoon.

The question of lead-in time has been raised and the difficulty that some exporters have with the commercial insurance market in obtaining security through extended periods. I think that it's true of most commercial schemes that they are prepared to meet that problem. They are prepared to establish capacity as available at an early stage in exchange for some sort of contingent fee and, indeed, they may well be prepared to make a commitment that the capacity will be available at a particular price. The fee in respect to that tends to be higher because the insurer is being asked to guarantee to have something available, whereas the exporter is saying, "We may not require it when it comes to that point."

The other point I think I'd like to make as I have the opportunity is to say that the commercial market itself is intensely competitive on this business. Often it's one company in the United States against another and against foreign insurers, such as they are, against Lloyd's, and indeed there is great competition within Lloyd's. The business is perceived as being attractive in parts.

If the individual exporters are unable to find sympathetic treatment in respect to their individual, very high risk propositions, I think that relates as much to the selectivity that they have in coming to insurers as to any other single fact.

I think that concludes the introductory remarks and I'm grateful for having the opportunity to make them.

[Complete statement follows:]

STATEMENT OF STEPHEN R. MERRETT, UNDERWRITER AT LLOYD'S, LONDON

Mr. Chairman and Members of the Subcommittee, good afternoon. I am pleased to be with you today. My name is Stephen R. Merrett. I am an Underwriter at Lloyd's, London, and one area of my underwriting expertise is political risk insurance.

My involvement with political risk insurance affecting American insureds goes back more than a decade. My syndicate was an early reinsurer of the Overseas Private Investment Corporation (OPIC), and since its inception, I have been a member of the Board of Governors of the Overseas Investment Insurance Group (OIIG), which you will recall operates a combined underwriting and reinsurance pool with respect to political risk insurance. I was privileged to serve as the first Chairman of the Underwriting and Claims Committee of OIIG. I also have been involved in the reinsurance of the political risk mechanisms of other countries.

Although I am a Member of the Council and Committee of Lloyd's, I should not be considered an official Lloyd's spokesman. Lloyd's, as you know, is a highly competitive market and each underwriter has his own views as to underwriting matters.

It would be presumptuous for me to take a position on the merits of your bill. Traditionally, Lloyd's has operated successfully in competition and in partnership, as a co-insurer or reinsurer, with both government, as well as private insurance mechanisms. My comments are directed to the issues you raised in your letter of July 20, 1983, to our U.S. General Counsel, Messrs. LeBoeuf, Lamb, Leiby & MacRae.

The first issue you raised was whether there is adequate coverage against losses arising from the imposition of export controls currently available from public and private sources.

I understand that there has traditionally been a market in the United States for this coverage provided by the FCIA/Ex-Im Bank but that certain coverages have been limited. We at Lloyd's have provided similar coverages either as a part of a broad policy cover or as a specific risk in itself, upon request, both directly and by means of reinsurance.

The size or capacity of any insurance market is determined by the availability of a balanced spread of business perceived by insurers as likely to provide them with reasonable profits over a period of time. Assuming that the choice of purchase of insurance is a free one, insurers may be able to balance the exposure in areas where the perceived risk is higher by selective rating. To develop substantial capacity, insurers require a consistent supply of business, so that appropriate reinsurance arrangements may be made. The ability of insurers to respond to crisis requirements where action of the Administration is seen to be imminent is very limited. Those who offer this coverage do so with the advantage of a substantial book of general political risks business which helps to provide the required balance.

The second issue concerns the cost and terms of such coverage.

The cost would be determined either as a charge on the whole export portfolio if an exporter required world-wide all-product cover, or presumably as a higher charge on those exports thought to be particularly exposed to Administration action. Implicit in this issue is what would be termed "affordability" of such insurance. My experience is that in some cases exporters seek this insurance only after the threat of injury is imminent. Certainly, at that stage, if the coverage is available at all, a premium must be considerably higher to correspond with the increased risk. In such cases the exporter may deem the premium to be unaffordable, in light of the profit margin on his contract.

Coverage is largely provided on manuscript wording designed to meet the specific requirements of an individual exporter.

The third issue is the process by which claims are subject to review. I confess to some confusion as to what you mean by this issue. Claims which arise under this type of insurance would be adjusted just like any other claims. It should be a straightforward matter to determine that the specified event has occurred and that none of the policy conditions have been breached.

You wish to investigate whether other countries provide similar coverage. Other major trading nations do provide some coverage to their exporters. In general, in the European Economic Community, although coverage is available, it is usually offered as an extension to a "whole turnover" political risk cover and, often, would not be affordable to the exporter.

It is difficult for me to assess the degree to which the proposed insurance program would insulate the U.S. economy from the effects of export controls.

Insurance can insulate the individual exporter from the adverse effect of controls, or spread the effect more widely. If the insurance is actuarially sound in the sense of not requiring a subsidy, however, it cannot insulate the economy as a whole.

Mr. Chairman, I would be pleased to answer any questions the Subcommittee may have.

Senator DODD. Well, we thank you very much again. We will take your formal statement and make it a permanent part of the record. Certainly your supplemental remarks are appreciated.

DEGREE OF POLITICAL RISK MUCH LOWER IN EUROPE

I'm curious. I pointed out earlier that there are a number of European countries which do have a public or quasi-public political risk insurance program.

What has been Lloyd's experience in terms of competing in those countries? And they are numerous, including Great Britain. What has been your experience in terms of the private commercial insurers' ability to write political risk insurance in those nations where there are public programs?

Mr. MERRETT. It's our general experience that those programs are used much more intensively by small companies to whom it makes good sense to buy the complete package of insurance, particularly a preshipment risk, which is generally a requirement.

Senator DODD. Smaller companies go to the public sector or go to the commercial market?

Mr. MERRETT. They go to the government schemes because they need comprehensive coverage, generally speaking, that the government scheme is required to give if they are to give the export embargo coverage as well. That particular coverage is not in the ordinary way or indeed at all, to my knowledge, available as an individual risk, from government insurance schemes.

The larger companies on individual contracts are able to arrange much better to cope without insurance with most of the preshipment risks and therefore will probably find the commercial insurance more competitive for the single risk.

But having said that, I do think it's notable that the perception of the degree of that risk in Europe is much lower than it is in the United States and clearly mostly because the risk itself is lower, as has been previously stated, that European governments in general do not use a trade embargo as a part of their ordinary series of measures to be taken for political ends.

Senator DODD. Let me take an argument against this form of political risk insurance and suggest that in fact the contrary might be the case, that the existence of political risk insurance in European countries contributes to respective governments, regardless of their political persuasion, from exercising export controls because there is a political risk insurance program.

Mr. MERRETT. The best evidence I can give you against that, Senator, is I think the wholesale lack of profitability of European political risk insurance schemes. I don't believe the things are connected at all and do not see European governments wish to avoid underwriting losses as a factor.

Senator DODD. You mentioned the comprehensive nature of the quasi-public or totally public programs. Do many of these programs have limitations on liability to such an extent that the larger enterprises wouldn't tend to go near them because they couldn't cover the losses should they occur, or are there no caps at all on these public programs?

Mr. MERRETT. As far as I am aware, all the ones which are in government programs are backed by the full faith and credit and therefore seem to be more secure as an insurance risk.

Senator DODD. I think your point on rates is a very good one because there is a difference in risk and to assume that there could be a standard rate would be terribly naive. However, maybe I'm being naive to assume that there would be excessive political pressure to set standard rates in this country for those programs.

Has that been a political problem Europe or Japan? Do they have difficulty establishing actuarially sound political risk insurance programs, public or quasi-public?

Mr. MERRETT. I think that the published record of debtors would indicate that they have, that there is no actuarial soundness in the underwriting. But that doesn't distinguish this particular risk from the general risks they cover, and most of the losses of course, have been more on the financial side of the contracts that they have guaranteed, nonpayment from wherever it may be, Nigeria or somewhere.

Senator DODD. You anticipated my next question. So it's not as a result of payments out, but really, rather, how they are managed. Do they collect at least part of the premium cost from the private sector?

Mr. MERRETT. Oh, yes. The obligation, as far as I know, of all of them, all the European schemes, is that they should be self-sustaining and they do charge a premium for the risk they undertake. It's just that in hindsight the premiums have proved to be, generally speaking, inadequate.

Senator DODD. Inadequate?

Mr. MERRETT. Yes, sir.

Senator DODD. Again, I thank you. We'd like to stay in touch with you as we work on this notion and idea and, again, we are grateful to you for coming such a great distance to appear before us today. I hope you're not going right back to England. I hope you're going to get a rest.

Mr. MERRETT. I am indeed going right back, Senator, but we do a great deal of business in this country and we believe that unless we get business we can't make any money, and in no sense are we therefore in a competitive position here. We are not trying to push business your way or to take business from you, speaking of you as a Government scheme, and I think it's very much in our interest to make as good an explanation of the way we see the problems in the legislation proposed as we possibly can, and we will continue to supply whatever information you require. I'm grateful for your hospitality.

Senator DODD. That's extremely gracious of you to make that offer and we appreciate it greatly. On behalf of the Banking Committee and on behalf of this subcommittee and certainly on behalf of the Senate as a whole, we appreciate that. Thank you.

Mr. Svensk, thank you for being patient. This particular problem has come up. You've heard the general guidelines. If you'd like to paraphrase your statement, your remarks will be made a formal part of this record and you can proceed any way that you feel most comfortable.

STATEMENT OF ROBERT E. SVENSK, PRESIDENT, AMERICAN INTERNATIONAL GROUP POLITICAL RISK, INC., NEW YORK, N.Y.

Mr. SVENSK. For the record, I am Robert Svensk and my formal remarks will be submitted for the record.

With me today is Ned Cloonan, who is the AIG public affairs officer in Washington, D.C.

I would rather take questions and just highlight a few aspects of our position.

As you have read, we noted that we believed the proposed insurance act to be somewhat redundant with existing programs offered through the Eximbank and through commercial private underwriters. We questioned whether it could be underwritten on an economically viable basis and we question, as did most of the other witnesses today, whether it was the proper solution to the problem of assisting U.S. exporters, enhancing their market reputation, increasing their exports, et cetera.

We have, for the record, lived through one embargo following the Russian invasion of Afghanistan and the subsequent imposition of controls placed on various exporters, and it was a most enlightening experience as to how the export administration licensing procedures are, in fact, administered. They are complex at best.

I, in general, agree with Mr. Merrett's comments as to whether such a program could be underwritten on a self-sustaining basis. I believe that it is the opinion of the private underwriters that if it could be written on a self-sustaining or even a marginally profitable basis that we, in fact, would be offering insurance along these lines on a broader basis.

The fact that we take a very conservative approach and the fact that it is not, as Mr. Seccombe and others pointed out, available in unlimited quantities at very, very reasonable rates attests to the fact that it is probably not an actuarially sound cover to underwrite, especially as a one-product coverage. It is typically sold with nonpayment insurance and other types of political and commercial insurances, and rarely is it sold as a stand-alone product.

The possibilities for adverse selection, in terms of exporters wanting to buy the insurance only in markets of greatest risk, is obviously there and that, in and of itself, makes the underwriting on a normal basis impossible.

I would also like to point out that the political risk insurance offered by our foreign competitors is offered through their existing export credit insurance agencies—their respective FCIA's. I believe in the United Kingdom, only the ECGD writes that as part of a broad range of other insurances offered, and to do so in this situation brings us back to many of the points that were raised earlier as to restrictions on the Eximbank for writing coverages in those countries that are politically sensitive in Eastern Europe, North African countries, South Africa, and the question of how much support the U.S. Government really wants to give to countries that, at the same time, are those that are most likely to be the subject of export controls.

We appreciate the opportunity to put our formal remarks in and in the interest of time I will close and accept any questions you may have.

[The complete statement follows:]

ROBERT E. SVENSK, PRESIDENT, AIG POLITICAL RISK, INC.

I am Robert E. Svensk, President of AIG Political Risk, Inc., a subsidiary of the American International Group. I am pleased to have the opportunity to appear before this Subcommittee this afternoon.

AIG Political Risk, Inc. ("AIGPRI") is one of the largest export credit and political risk insurance underwriters in the world. In 1982, we insured over $5 billion of exports against various commercial and political risks, including the risks of export license cancellation and embargo.

In principle, we agree with Senator Dodd's underlying rationale for the Political Risk Insurance Act of 1983; namely, that the imposition of export controls has a negative impact on U.S. exporters by imposing unrecoverable out-of-pocket and opportunity costs on them. Also, in principle, we support Senator Dodd's desire to mitigate these potential costs to U.S. exporters and thereby foster a more favorable export climate for U.S. companies.

We do not believe, however, that the proposed Political Risk Insurance Act of 1983 ("PRIA") is necessary, economically viable, or a meaningful resolution for the basic problem which this proposal seeks to remedy.

First, we believe the PRIA to be unnecessary as it would be redundant on two accounts. The United States Government already offers the contemplated insurance through the U.S. Export-Import Bank ("Eximbank") and its underwriting agency, the Foreign Credit Insurance Association ("FCIA"). Export license cancellation/embargo insurance is, however, only available from this source in those countries where the FCIA/Eximbank insurance programs are operative. Conspicuously absent from their list of eligible countries, however, and probably the country of greatest concern to U.S. exporters is the U.S.S.R. Export license cancellation insurance is also not available from the FCIA/Eximbank for sales to Libya, South Africa, or East Germany, and other select countries.

The unavailability of export license cancellation coverage (and the FCIA/Eximbank program in general) in these countries is more for reasons of public policy than for commercial reasons, as relative to other markets this group represents a commercially viable market segment. If the U.S. Government wanted to make this insurance available in these sensitive countries, it could readily do so through existing governmental institutions.

Secondly, the type of insurance proposed under the PRIA is currently available in the private insurance market. Creation of a new facility under the auspices of the Department of Commerce would, in our opinion, represent an expanded competitive undertaking by the U.S. Government with the private insurance industry. Today there are five U.S. underwriters of political risk insurance, as well as various syndicates at Lloyds of London which are ready, willing and able to underwrite export license cancellation/embargo insurance within the limits of acceptable risk assumption. The collective capacity of this market is in excess of $100 million any one risk, a capacity which is more than adequate to meet the needs of the market. It is our opinion that the role of the government should be limited to meeting needs which cannot be satisfied by the private sector.

Let me briefly outline the nature and scope of this insurance and say a few words on how it is underwritten at AIG Political Risk, Inc. First, we do not insure against failure to receive the appropriate authorities to export, only against the revocation of an existing authority to export. Secondly, this particular coverage is typically sold as part of a package of coverages to an exporter . . . the other coverages typically including contract repudiation, nonpayment coverage, currency inconvertibility, contract frustration caused by such political events such as revolution or insurrection or by other commercial events such as insolvency of the buyer. It is infrequently sold by itself as (a) there is little cost advantage to the exporter for buying less than the package of coverage, and (b) if the insurance is being used as a financing tool, this limited coverage for embargo only is not normally adequate to facilitate a non-recourse financing package.

As with all export credit/political risk insurance, the exporter is typically required to retain a small portion (e.g. 10 percent) of the risk for his own account. Also, the definition of loss encompasses only costs and expenses incurred if the contract is frustrated prior to shipment and the buyer has not been invoiced. The objective of this underwriting approach is to ensure that exporters will not behave differently or assume risks they otherwise would not assume simply because they have purchased an insurance policy. Export credit and political risk insurance, like all forms of insurance, exist to protect an insured against fortuitous and unexpected events.

The costs and terms of private insurance market embargo coverage vary from underwriter to underwriter. The larger question for us at AIG Political Risk, Inc., in reviewing a submission by an exporter, for, say, license cancellation insurance on a sale to the U.S.S.R. is usually not so much a matter of price or terms, but rather whether such a sales contract is underwritable at all. Certainly, it there are known problems with a particular product or project or we expect a controversy within the

U.S. Government as to whether a project will be subject to export controls or not, it is unlikely that AIG Political Risk, Inc., or any private underwriter would offer embargo coverage on that submission at any price. Underwriters do differ in their approach, however. While AIG Political Risk, Inc. did not offer coverage for U.S. exporters to the TransSiberian Gas Pipeline Project, we did hear of instances where coverage was purchased.

This brings me to my second point, namely, that the program contemplated under the PRIA may not be economically viable or self funding as described. The program as proposed is expected to be self funding. However, the amount of funds available to pay losses under the proposed self-funding mechanism would not be significant. It would be ideal for a private underwriter to limit his losses in the event of a catastrophe to the amount of premium, less expenses, plus investment income on hand the day the catastrophe occurs. Under such a system, one could virtually underwrite any type of coverage on any terms desired. However, it would be difficult to sell as an insured would not be certain of what amount of insurance he had purchased should there, in fact, be a claim on the funds.

Secondly, the program contemplates coverage only against loss caused by the imposition of export controls. The countries where such coverage is desired are limited. Thus, one would not be able to develop a significant premium volume given the limited product line, the limited countries of interest, and the voluntary nature of the program. The costs of selling and administering such a program could alone consume a disproportionate percentage of the premium collected. The U.S. Government would also have to consider how much support it wants to give to U.S. exporters doing business in countries which have traditionally been considered inappropriate for U.S. Government support.

Given the adverse selection of risks such a program would attract, it would be difficult to reinsure these risks with the private insurance market as envisioned in the proposed legislation, especially when the private insurance markets could have underwritten the same risk itself, if so desired. The more appropriate approach here would be for the U.S. Government to provide reinsurance to the private sector underwriters in those situations where the private underwriters do not believe they can adequately carry the risk. Such an arrangement would relieve the Department of Commerce of most of the selling and administrative costs of such a program and would also offer support to U.S. exporters without the U.S. Government competing with private U.S. insurance companies.

The third aspect of the PRIA we would like to address is whether such a program adequately addresses the problem, or whether it is like using a bandaid to repair a heart attack. This issue of export controls is an emotional one for AIG Political Risk, Inc. and for other private underwriters who have paid claims as a result of such U.S. Government actions. I am sure those exporters who have had losses as a result of such actions, but who were not insured, are equally as emotive on the subject. The problem in our view rests more with the general administration of export licensing procedures and guidelines by the U.S. Government. No amount of insurance can undo the confusion and costs associated with even determining whether a validated export license is needed or not. Furthermore, no amount of insurance can undo the unsavory reputation as an unreliable supplier which U.S. firms attract when they are not allowed to perform under contracts which were signed long before the export controls were imposed. This reputation certainly effects future sales to all countries. Lastly, no amount of insurance can overcome the problems of bidding on contracts competitively when an air of uncertainty hangs over a U.S. firm's ability to ultimately enter into a contract.

We certainly recognize the right of the U.S. Government to impose export controls in the interests of national defense and, in extreme cases, the interests of foreign policy. In such cases, the availability of political risk insurance can mitigate the costs to the U.S. exporters who are affected. However, the maintenance of U.S. technological leadership and on-going foreign policy objectives can, in our opinion, be better served by an export administration program which is consistent and comprehensible to U.S. exporters and which firmly establishes the ground rules before an exporter enters into bidding on or signing a contract from which he cannot back out. In speaking with exporters, it is our general impression that consistency in the U.S. Government's export licensing policy is more important to them than whether any particular transaction is doable or not.

CONCLUSION

We thank the Subcommittee once again for the opportunity to share our views on the PRIA with you, and we commend Senator Dodd's appreciation of the problem

and desire to mitigate the negative aspects of a necessary foreign policy tool. We believe, however, that the PRIA, as presently contemplated, is (a) redundant with existing facilities in the private insurance market and in the public market, (b) is not economically viable, and (c) is not a meaningful resolution for the problems which it seeks to remedy.

Senator DODD. Thank you very much again for your comments and for being here. I believe you were sitting here during the testimony of our exporters and you heard all of them say, to a person, about the difficulties—the unavailability of insurance. Earlier, you heard affordability problems that occurred, and now it's a question of lack of availability.

Putting aside for a second your AIG hat, you obviously understand these problems and we are suffering economically because of our inability to develop export markets. We've heard witnesses today talk about how their own industries have cut back substantially because of the risks involved.

I'm sure you agree, or at least to an extent you agree, with the notion that Presidents of the United States ought to be able to exercise the foreign policy of this country so it serves the best interest of all of us and from time to time there will be export controls imposed which cause great concern.

What do you recommend we do in this kind of a situation?

HONOR CONTRACTS IN PLACE AND PROVIDE REINSURANCE

Mr. SVENSK. Well, I have two particular recommendations. One, which was addressed earlier, is to create a more consistent export license policy and to honor contracts that are in place. To most of the exporters I've spoken with, the certainty of being able to perform under a contract is more important than whether that particular contract is allowed to go ahead or not. Obviously, while the latter is desirable, given a tradeoff, I think anybody would say that we would rather have consistency, we would rather be told that we can't do something and not bother to waste time, resources and energies getting halfway down the road and then being told we can't proceed.

Senator DODD. I would agree with you on that, but I was once told by Richard Helms, speaking in his former role as director of the Central Intelligence Agency, "Mr. Dodd, it's an untidy world." We live in an untidy world and we do business with countries from time to time who do things that are not terribly consistent with normal human values and many times the contracts and the business that our private companies enter into with foreign companies or governments substantially assist them economically, as well as ourselves.

And short of some other reprisal which would be far more deleterious, we are oftentimes left with no other recourse as a way of expressing our outrage over their behavior.

What do you do in that kind of situation?

Mr. SVENSK. In the great scheme of things, we have no problems insuring contracts under that environment. Obviously, this type of insurance exists to protect against fortuitous events, such as the Russian invasion of Afghanistan and subsequent U.S. Government actions taken in response there to.

What we have seen happen, however, as with the Siberian pipeline case, is an issue become a tennis ball where nobody knows where they stand at any point in time. For people who are attempting to bid on contracts that is a difficult situation.

The second recommendation would be to look at existing government programs, the obvious one is the Eximbank programs to see whether they could accommodate this coverage.

Senator DODD. You know what's happened to FCIA.

Mr. SVENSK. I certainly do.

Senator DODD. You're aware of their solvency problems. They're going out of business.

Mr. SVENSK. We certainly are. We have been a participant and will be until October 1 of this year in the FCIA program.

A third recommendation, which I mentioned in our prepared statement, would be to have the U.S. Government provide reinsurance to private underwriters, be it through a separate program or through the Eximbank. We tend to deal with a wide range of exporters. If, in difficult markets the U.S. Government reinsurance program were available to us, that would be an attractive approach to the problem.

Inducing private underwriters to reinsure a government program would be infinitely more difficult, given, as Mr. Merrett pointed out, the likelihood of that program to attract only the worst type of risks, which we would not be willing to underwrite to begin with.

Senator DODD. I don't really blame you for not wanting to do a lot of this—that is, the underwriting of these risks—given the track record. I don't think even the exporters really blame you for that. I think you would probably find a lot of common ground there. They are not pointing a finger of responsibility at you. I think it's just their frustration of wanting to do business overseas and having to protect their substantial investments and reinsurance—while it has some certain attractive merits, I think it's going to be extremely difficult to sell as a concept. It's hard enough to talk about this without scaring a lot of people to death. Start talking about reinsurance and you're really going to have a number of bills.

Mr. SVENSK. Well, providing the insurance through the private sector at least eliminates most of the cost elements of administering the program. They are basically borne by us as the underwriting manager.

Senator DODD. Let me ask you. I was under the impression that your feelings were that at relatively reasonable rates that insurance was available.

Mr. SVENSK. For projects which are not already subject to controversy at the time the exporters arrive at our door seeking insurance. We tend to see only the difficult risks, for example, the Siberian pipeline, the Kama River truck factories, laser beam welders for the Kubichev drill factory. We rarely see more normal types of products in less sensitive areas being exported and requesting this type of insurance coverage.

Senator DODD. I can't resist asking this question. Would you underwrite a contract in El Salvador today?

Mr. SVENSK. In El Salvador? No.

Senator DODD. I don't blame you.

Was there anyone who did underwrite the insurance on the pipeline deals at all?

Mr. SVENSK. I understand that quotations, not by us, were offered to certain manufacturers for the pipeline project. Whether they were purchased, I do not know.

Senator DODD. You don't know the cost?

Mr. SVENSK. I can't say.

FREE AND FAIR EXPORTING MAY HAVE TO CHANGE

Senator DODD. In your statement you indicated that you felt that a public program in fact could be injurious to the private commercial insurers, at least in this particular area, despite the actuarial situations that Mr. Merrett pointed out in Europe, where it doesn't appear as though that has been a problem.

On what do you base the fear that this would already affect private carriers?

Mr. SVENSK. First, we have a general problem with all insurances that may be offered by us where the Government steps in and offers some aspect of it. Given our need to underwrite on a profitable basis, we may not be able to be price competitive with a U.S. Government program that takes as a starting point only self-sufficiency. Second, given other commercial constraints we may not be at all able to compete termwise with Government programs.

Senator DODD. Well, barring the consistency that we'd all like to see in U.S. foreign policy from one administration to the next which would eliminate a substantial part of the reason for even having a hearing today, recognizing that that is going to be a problem we will live with for some time to come, and recognizing further the importance of this issue in terms of our own economic recovery, do you have any recommendations you might make to us?

Mr. SVENSK. None other than some form of U.S. Government reinsurance program of private underwriters or a possible expansion of the Eximbank/FCIA type programs. I would possibly like to reserve judgment and get back to you, if I may, if I have some additional ideas.

Senator DODD. I wish you would, because this is obviously your business and you know and understand it. Some good advice from the insurance industry could be extremely helpful.

We've all heard and I have given the speech as well, the free and fair trade speech, and we hear it loudly, Mr. Merrett, when our good friends and colleagues come from your distinguished Parliament and others as well. The ugly fact is it's not terribly free or fair anyway and it doesn't seem as though we are reversing that cycle at all. If anything, it's getting worse. And my fear is that while it's nice to give speeches about free and fair trade, we are going to have to do something or we are going to look awfully foolish if we continue to lose our fair share of the export market overseas. We are going to pay a very dear price indeed for it.

It's a problem that we don't have any time to waste on. We're already way behind in dealing with this. And my hope would be that we might come up with an intelligent, thoughtful program that would meet the legitimate concerns of your industry, that

would meet the fears and worries of exporters and others, that would be able to put us on the right track again.

So I would appreciate it if you could give it some thought and get back to us with some suggestions on how we might try to design a program that would do what we all have agreed upon today is a worthwhile effort and one that we ought to get about the business of accomplishing, sooner than later.

So again, on behalf of Senator Heinz and this committee, we thank you for being here with us today. We appreciate your patience as well in putting up with this schedule. Thank you very much.

This committee will stand adjourned.

[Whereupon, at 5:25 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

Response to Record

Assistant Secretary Brady's Testimony

Question by Senator Dodd

Senate Banking Committee Hearing (page 12)

S 1568, Political Risk Insurance Act of 1983

Eximbank currently offers pre-shipment cover for exports to most countries through its affiliate, the Foreign Credit Insurance Association (FCIA) and under the Bank's own medium-term contract guarantee program. This coverage provides protection against the cancellation or failure to renew a validated U.S. export license or the imposition of restrictions on the export of products not previously subject to license or restriction. (In addition, pre-shipment cover protects against (1) cancellation of foreign import licenses in sales to private buyers and (2) bankruptcy of private buyers prior to shipment.) Demand has been modest.

The cover is not complete in all respects. Pre-shipment cover currently is unavailable for the USSR, Eastern Bloc countries except Hungary and Romania, and South Africa due to statutory and foreign policy considerations. Coverage for sales to the USSR has been suspended since the Afghanistan crisis; coverage for Eastern European countries depends on whether Eximbank facilities are generally operative in those countries. Only products normally sold on short- and medium-term credit are eligible for cover.

In addition to the above pre-shipment cover, the U.S. Government offers several other guarantee and insurance programs to facilitate U.S. trade and investment. These programs include: (1) Eximbank guarantees and FCIA insurance to commercial banks and exporters for short- and medium-term export financing, (2) OPIC guarantees an insurance to facilitate private U.S. investment in friendly developing countries, (3) Commodity Credit Corporation guarantees to commercial banks financing export sales of agricultural commodities on terms up to three years.

With respect to the number of U.S. exporters who may have experienced some economic effect from the President's export control sanctions imposed in December 1981 and June 1982, the actual numbers are relatively small. Losses for U.S. exports to the Soviet Union occassioned by the so called pipeline sanctions was estimated at about $200 million annually. Although the number of U.S. firms with contracts was small, perhaps fewer than thirty, a number of other firms such as sub-contractors and secondary suppliers were no doubt also affected.

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